FAMILY AND CHARITABLE PLANNING WITH RETIREMENT ACCOUNTS

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WHAT IS GOING ON WITH THE FEDERAL ESTATE TAX?

The 2001 tax act significantly increased the amount that a person's estate can have at death without being subject to estate tax. The estate tax was completely repealed in the year 2010 (with an option to have it apply at a $5 million level to obtain a stepped-up income tax basis in inherited property). The 2010 tax act provided a two year record high threshold of $5 million for the estate tax, gift tax and generation skipping tax.

The thresholds are summarized in the table below (changes are highlighted in bold):

Year	Lifetime Gift Tax Threshold	Estate Tax Exemption Amount	Highest Estate & Gift Tax Rate
2001	$675,OOO	$675,OOO	55% (+5% surtax)
2002-03	**$1 million**	**$1 million**	50%
2004-05	$1 million	**$1.5 million**	48%
2006-08	$1 million	**$2 million**	45%
2009	$1 million	**$3.5 million**	45%
2010	**$5 million**	**Repealed !**	**<<***Carryover basis*
		or	
	$5 million	**$5 million**	<<*Step-Up basis* **(35% tax rate)**
2011-12	$5 million	$5 million	35%
2013	**$1 million**	**$1 million**	**55% (+5% surtax)**

* The generation skipping tax threshold is also a remarkable $5 million in 2011 & 2012, increased from the usual $1 million threshold.

FEDERAL ESTATE TAX RETURNS
RETIREMENT PLAN ASSETS AND ANNUITIES; CHARITABLE DEDUCTIONS

	TOTALS		RETIREMENT PLANS/ANNUITIES				CHARITABLE DEDUCTIONS			
Year Filed	# of Returns	Gross Estates (millions)	# of Returns	%	Value (millions)	%	# of Returns	%	Value (millions)	%
2011est	8,238	$120,666	5,193	63	$ 5,721	4.7	2,227	27	$13,398	11.1
2007	38,031	$203,096	23,230	**61**	$13,993	**6.9**	7,672	**20**	$19,702	**9.7**
2004	62,718	$192,635	36,733	59	$17,499	7.5	11,599	18	$14,958	7.8
2001	108,112	$215,649	58,664	54	$18,398	**8.5**	18,711	17	$16.150	7.5
1998	97,856	$173,798	45,752	47	$12,039	6.9	16,982	17	$10,861	6.2
1995	69,772	$117,735	30,938	44	$ 6,632	5.6	13,063	19	$8,707	7.4
1992	59,176	$ 98,850	22,738	38	$ 4,095	4.1	11,053	19	$6,785	6.9
1989	45,695	$ 77,997	14,223	31	$ 2,309	3.0	8,471	19	$4,925	6.3
1986	45,125	$ 59,805	11,244	**25**	$ 1,350	**2.3**	7,835	**17**	$3,573	**6.0**

SOURCE: IRS Statistics of Income Bulletins. See web <http://www.irs.ustreas.gov/prod/tax_stats/estate.html>

Estate Tax Returns Filed in 2002: Estate Size and Charitable Deductions

[All figures are estimates based on samples--money amounts are in thousands of dollars.]

Size of Gross Estate	Gross Estate		Charitable deduction				Average amt (in thous. $)
	Number of returns	Amount (in thous. $)	Number of returns	(%) of returns	Amount (in thous. $)	(%) of estate	
All returns	**98,359**	**$ 211,212,218**	**16,105**	**16%**	**$ 17,828,921**	**8%**	
$ 675,000 < $ 1,000,000	36,809	30,210,377	4,624	13%	683,015	2%	148
$ 1,000,000 < $ 2,500,000	46,361	68,575,863	7,688	17%	3,131,444	5%	407
$ 2,500,000 < $ 5,000,000	9,882	33,618,289	2,097	21%	1,819,776	5%	868
$ 5,000,000 < $10,000,000	3,439	23,598,243	970	28%	1,749,224	7%	1,803
$10,000,000 <$20,000,000	1,198	16,187,674	420	35%	1,523,675	9%	3,628
$20,000,000 or more	671	39,021,771	307	46%	8,921,787	23%	29,061
Taxable returns	**44,407**	**$ 117,230,253**	**8,691**	20%	**$ 11,509,315**	10%	
$ 675,000 < $ 1,000,000	13,026	11,265,400	1,355	10%	34,765	0%	26
$ 1,000,000 < $ 2,500,000	22,993	33,795,007	4,576	20%	582,739	2%	127
$ 2,500,000 < $ 5,000,000	5,049	17,433,073	1,405	28%	702,587	4%	500
$ 5,000,000 < $10,000,000	2,101	14,544,190	762	36%	1,062,025	7%	1,394
$10,000,000 < $20,000,000	755	10,250,877	330	44%	908,359	9%	2,753
$20,000,000 or more	484	29,941,706	262	54%	8,218,840	27%	31,370
Nontaxable returns	**53,952**	**$ 93,981,965**	**7,414**	14%	**$ 6,319,606**	7%	
$ 675,000 < $ 1,000,000	23,783	18,944,977	3,268	14%	648,250	3%	198
$ 1,000,000 < $ 2,500,000	23,368	34,780,856	3,112	13%	2,548,705	7%	819
$ 2,500,000 <$ 5,000,000	4,833	16,185,216	692	14%	1,117,189	7%	1,614
$ 5,000,000 < $10,000,000	1,338	9,054,053	208	16%	687,198	8%	3,304
$10,000,000 <$20,000,000	443	5,936,797	90	20%	615,316	10%	6,837
$20,000,000 or more	187	9,080,065	45	24%	702,947	8%	15,621

For this and other IRS statistics, see the IRS web cite <http://www.irs.ustreas.gov/prod/tax_stats/estate.html>.

Estate Tax Returns Filed in 2002: Retirement Plans, IRAs and Annuities

[All figures are estimates based on samples--money amounts are in thousands of dollars.]

Size of Gross Estate	Total Estate Tax Returns		IRAs, Retirement Plans & Annuities				Average amt
	Number of returns	Amount (in thous. $)	Number of returns	(%) of returns	Amount (in thous. $)	(%) of estate	(in thous. $)
All returns	**98,359**	**$ 211,212,218**	**55,168**	**56%**	**$ 17,498,702**	**8%**	
$ 675,000 < $ 1,000,000	36,809	30,210,377	19,858	54%	3,340,282	11%	168
$ 1,000,000 < $ 2,500,000	46,361	68,575,863	26,887	58%	8,102,511	12%	301
$ 2,500,000 < $ 5,000,000	9,882	33,618,289	5,842	59%	3,448,768	10%	590
$ 5,000,000 < $10,000,000	3,439	23,598,243	1,673	49%	1,520,009	6%	909
$10,000,000 <$20,000,000	1,198	16,187,674	580	48%	602,709	4%	1,039
$20,000,000 or more	671	39,021,771	329	49%	484,422	1%	1,472
Taxable returns	**44,407**	**$ 117,230,253**	**21,093**	47%	**$ 6,546,006**	6%	
$ 675,000 < $ 1,000,000	13,026	11,265,400	6,399	49%	1,090,216	10%	170
$1,000,000 < $ 2,500,000	22,993	33,795,007	10,874	47%	2,945,366	9%	271
$2,500,000 < $ 5,000,000	5,049	17,433,073	2,518	50%	1,275,626	7%	507
$5,000,000 < $10,000,000	2,101	14,544,190	793	38%	659,442	5%	832
$10,000,000 <$20,000,000	755	10,250,877	302	40%	283,725	3%	939
$20,000,000 or more	484	29,941,706	206	43%	291,631	1%	1,416
Nontaxable returns	**53,952**	**$ 93,981,965**	**34,075**	63%	**$ 10,952,696**	12%	
$ 675,000 < $ 1,000,000	23,783	18,944,977	13,458	57%	2,250,066	12%	167
$1,000,000 < $ 2,500,000	23,368	34,780,856	16,013	69%	5,157,145	15%	322
$2,500,000 < $ 5,000,000	4,833	16,185,216	3,324	69%	2,173,142	13%	654
$5,000,000 < $10,000,000	1,338	9,054,053	880	66%	860,567	10%	978
$10,000,000 <$20,000,000	443	5,936,797	277	63%	318,984	5%	1,152
$20,000,000 or more	187	9,080,065	123	66%	192,791	2%	1,567

("Taxable Returns" and "Nontaxable returns" -- Most non-taxable returns claimed the marital deduction to avoid the federal estate tax (typically the estate of the first spouse to die).

For this and other IRS statistics, see the IRS web cite <http://wwwirsustreasgov/prod/tax_stats/estatehtml>

Estate Tax Returns Filed in 2004: Retirement Plans, IRAs and Annuities -- Variations Based on Age and Gender

(A) Percent of Returns that Report Any Retirement Plan Assets and
(B) Percent of All Assets that are in Retirement Plan Accounts

	MALE		FEMALE	
ALL 2004 RETURNS	23,746	110,300 ($ millions)	18,493	75,621 ($ millions)
	% of returns with retirement assets	% of all assets	% of returns with retirement assets	% of all assets
% OF ALL RETURNS REPORTING RETIREMENT ACCOUNTS	47%	9%	31%	4%
Under age 50	63%	7%	64%	10%
Ages 50 to 65	69%	14%	62%	10%
Over age 65	43%	8%	28%	3%

Source: Brian G. Raub, "Federal Estate Tax Returns Filed for 2004 Decedents," Figures B and G, IRS Statistics of Information Bulletin, available at <http://wwwirsustreasgov/prod/tax_stats/estatehtml>. Percentage of returns is computed from 1998 data.

ESTATE TAX, GIFT TAX & GENERATION SKIPPING TAX CHANGES

From the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

[taken from pages 50-53 of the *Technical Explanation of the Revenue Provisions in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*; Joint Committee on Taxation, JCX-55-10 (Dec. 10, 2010)]

I. ESTATE TAX CHANGES

The estate and generation skipping transfer taxes are reinstated effective for decedents dying and transfers made after December 31, 2009 (i.e., the year 2010). The estate tax applicable exclusion amount is $5 million under the legislation and is indexed for inflation for decedents dying in calendar years after 2011, and the maximum estate tax rate is 35 percent. The estate of a decedent who died in 2010 also has the option to avoid paying the estate tax, in which case the beneficiaries will not get a step-up income tax basis in the inherited property but will instead use carryover basis, with adjustments. This is explained in Part IV below.

II. GIFT TAX CHANGES

For gifts made in 2010, the applicable exclusion amount for gift tax purposes is $1 million, and the gift tax rate is 35 percent. For gifts made after December 31, 2010, the gift tax is reunified with the estate tax, with an applicable exclusion amount of $5 million and a top estate and gift tax rate of 35 percent. *1*

III. GENERATION SKIPPING TAX

The generation skipping transfer tax exemption for decedents dying or gifts made after December 31, 2009, is equal to the applicable exclusion amount for estate tax purposes (e.g., $5 million for 2010). *2* Therefore, up to $5 million in generation skipping transfer tax exemption may be allocated to a trust created or funded during 2010, depending upon the amount of such exemption used by the taxpayer before 2010. Although the generation skipping transfer tax is applicable in 2010, the generation skipping transfer tax rate for transfers made during 2010 is zero percent. The generation skipping transfer tax rate for transfers made after 2010 is equal to the highest estate and gift tax rate in effect for such year (35 percent for 2011 and 2012).

1 The legislation clarifies current law regarding the computation of estate and gift taxes. Under the legislation, for purposes of determining the amount of gift tax that would have been paid on one or more prior year gifts, the estate tax rates in effect under section 2001(c) at the time of the decedent's death are used to compute both (1) the gift tax imposed by chapter 12 with respect to such gifts, and (2) the unified credit allowed against such gifts under section 2505 (including in computing the applicable credit amount under section 2505(a)(1) and the sum of amounts allowed as a credit for all preceding periods under section 2505(a)(2)).

2 The $5 million generation skipping transfer tax exemption is available in 2010 regardless of whether the executor of an estate of a decedent who dies in 2010 makes the election described below to apply the EGTRRA 2010 estate tax rules and section 1022 basis rules.

IV. INCOME TAX BASIS FOR INHERITED PROPERTY

A. General Rule

A recipient of property acquired from a decedent who dies after December 31, 2009, generally will receive fair market value basis (i.e., "stepped up" basis) under the basis rules applicable to assets acquired from decedents who died in 2009. Sec. 1014. The legislation generally repeals the modified carryover basis rules that, under EGTRRA, would apply for purposes of determining basis in property acquired from a decedent who dies in 2010. The legislation extends the EGTRRA modifications to the rules regarding (1) qualified conservation easements, (2) installment payment of estate taxes, and (3) various technical aspects of the generation skipping transfer tax.

B. Option for decedents who died in 2010: to avoid estate tax liability, take carry-over basis in inherited property, plus $1.3 million (or plus $3 million for spouse). IRS Form 8939: *Allocation of Increase in Basis for Property Acquired From a Decedent*

In the case of a decedent who dies during 2010, the legislation generally allows the executor of such decedent's estate to elect to apply the Internal Revenue Code as if the new estate tax and basis step-up rules described in the preceding section had not been enacted. In other words, instead of applying the above-described new estate tax and basis step-up rules of the legislation, the executor may elect to have present law (as enacted under EGTRRA) apply. In general, if such an election is made, the estate would not be subject to estate tax, and the basis of assets acquired from the decedent would be determined under the modified carryover basis rules of section 1022.*3* The election, once made, is revocable only with the consent of the IRS.

This election will have no effect on the continued applicability of the generation skipping transfer tax. In addition, in applying the definition of transferor in section 2652(a)(1), the determination of whether any property is subject to the tax imposed by chapter 11 of the Code is made without regard to an election made under this legislation.

3 Therefore, an heir who acquires an asset from the estate of a decedent who died in 2010 and whose executor elected application of the 2010 EGTRRA rules has a basis in the asset determined under the modified carryover basis rules of section 1022. Such basis is applicable for the determination of any gain or loss on the sale or disposition of the asset in any future year *regardless of the status of the sunset provision* .

V. PORTABILITY OF UNUSED EXEMPTION BETWEEN SPOUSES

Under the legislation, any applicable exclusion amount that remains unused as of the death of a spouse who dies after December 31, 2010 (the "deceased spousal unused exclusion amount"), generally is available for use by the surviving spouse, as an addition to such surviving spouse's applicable exclusion amount. The legislation does not allow a surviving spouse to use the unused generation skipping transfer tax exemption of a predeceased spouse.

If a surviving spouse is predeceased by more than one spouse, the amount of unused exclusion that is available for use by such surviving spouse is limited to the lesser of $5 million or the unused exclusion of the last such deceased spouse.[57] A surviving spouse may use the predeceased spousal carryover amount in addition to such surviving spouse’s own $5 million exclusion for taxable transfers made during life or at death.

A deceased spousal unused exclusion amount is available to a surviving spouse only if an election is made on a timely filed estate tax return of the predeceased spouse on which such amount is computed, regardless of whether the estate of the predeceased spouse otherwise is required to file an estate tax return.

Example – Assume that Husband 1 dies in 2011, having made taxable transfers of $3 million and having no taxable estate. An election is made on Husband 1's estate tax return to permit Wife to use Husband 1's deceased spousal unused exclusion amount. As of Husband 1's death, Wife has made no taxable gifts. Thereafter, Wife's applicable exclusion amount is $7 million (her $5 million basic exclusion amount plus $2 million deceased spousal unused exclusion amount from Husband 1), which she may use for lifetime gifts or for transfers at death.

Example With Remarriage.–Assume the same facts as in Example 1, except that Wife subsequently marries Husband 2. Husband 2 also predeceases Wife, having made $4 million in taxable transfers and having no taxable estate. An election is made on Husband 2's estate tax return to permit Wife to use Husband 2's deceased spousal unused exclusion amount. Although the combined amount of unused exclusion of Husband 1 and Husband 2 is $3 million ($2 million for Husband 1 and $1 million for Husband 2), only Husband 2’s $1 million unused exclusion is available for use by Wife, because the deceased spousal unused exclusion amount is limited to the lesser of the basic exclusion amount ($5 million) or the unused exclusion of the last deceased spouse of the surviving spouse (here, Husband 2’s $1 million unused exclusion). Thereafter, Wife's applicable exclusion amount is $6 million (her $5 million basic exclusion amount plus $1 million deceased spousal unused exclusion amount from Husband 2), which she may use for lifetime gifts or for transfers at death.

INCOME TAX CHANGES FOR 2011, 2012 & 2013

	2011	2012	2013
Social security rate cut to 4.2% (self-employed 10.4%)	*		
Lowest tax rate 10%; maximum tax rate 35%	*	*	
No phaseout of itemized deductions	*	*	
No phaseout of personal exemption	*	*	
Capital gains and dividends maximum 15% tax rate	*	*	
No "marriage penalty tax" for taxpayers in 15% tax rate	*	*	
$1,000 child tax credit rather than $500	*	*	
Exclude $5,250 for employer-provided assistance	*	*	
Expanded ability to deduct student loan interest	*	*	
Bonus 1st year depreciation-100% in 2011; 50% in 2012	*	*	
Sec. 179 equipment $500,00 in 2011; $125,00 future years	*		
Alternative Minimum Tax ("AMT") relief	*		
"Extenders" enacted for 2010 & 2011, including:			
-- Charitable IRA Rollover	*		
-- Itemized deduction for state sales taxes	*		
-- Deduction for tuition & fees	*		
-- 15 year deduction for restaurant improvements	*		
New 3.8%/0.9% health care taxes if AGI>$200k ($250k)			*

FUTURE INCOME TAX RATE INCREASES

Highest tax rates on:	2011-12	*Without Bush Tax Rates*	2013
Investment income (interest, rent)	35%	39.6%	43.4%
Wages (1.45% health ins + 0.9%)	36.4%	41.0%	41.9%
Dividends	15%	39.6%	43.4%
Long-Term Capital Gains	15%	20%	23.8%

OBSERVATIONS:

1. The "Bush Tax Rates" expire at the end of 2012, and the "Clinton Era" marginal income tax rates return – a maximum rate of 39.6%.

2. Beginning in 2013, wealthy taxpayers will also begin paying higher taxes to fund the national health programs. The taxes generally apply to individuals who have over $200,000 of income ($250,000 on a joint return) – ***not*** indexed for inflation.

a. *Medicare wage tax* - There will be a 0.9% additional tax on the compensation income of individuals who have over $200,000 of income ($250,000 on a joint return). This is paid only by the individual – not by the employer. This will be in addition to the existing 1.45% Medicare/Medicaid tax that employees pay on all of their earned income and that is matched by employers. Sec. 9015 (as modified by Sec. 10906 of *The Patient Protection and Affordable Care Act*, P.L. 111-148

b. *Surtax on Investment Income*

i - There is a 3.8% surtax on investment income (including long-term capital gains) for individuals who have over $200,000 of income ($250,000 on a joint return). Some income is exempt: retirement plan distributions and Subchapter S corporation or partnership income (provided the recipient is employed at the business). Sec. 1411(as modified by Sec. 1402 of *The Health Care and Education Reconciliation Act of 2010* (P.L. 111-152)

ii - Trusts and estates will incur the surtax on undistributed income of just over $12,000! Rethinking trust accumulation strategies?

c. *Strategies to keep income levels lower*

i - Expect municipal bonds to become much more popular for wealthy individuals

ii - Roth IRA conversions in years *before* 2013 to reduce future income

iii - If gains from property sales could spike income levels, consider gifts to tax-exempt charitable remainder trusts (before sale completed) or installment sales.

CHARITABLE IRA ROLLOVER IN 2012 ?

I. Introduction

The Pension Protection Act of 2006 permitted a person over age 70 ½ to make up to $100,000 of charitable gifts directly from an Individual Retirement Account ("IRA") from 2006 through 2011 (extended to 2011 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010). The donor will benefit by not having to report the IRA distribution as taxable income, although the donor will not be able to claim a charitable income tax deduction for the gift. Many retirees have been particularly motivated to apply their charitable IRA gifts to satisfy their mandatory minimum distributions. For example, a 76 year old who would normally be required to receive a taxable distribution of just over 4% from an IRA could satisfy the requirement by contributing 3% to a charity and receive a taxable distribution of just 1%.[1] NOTE: Congress waived all mandatory distributions in the year 2009 because of the severely depressed stock prices in 2008. (Worker, Retiree and Employer Recovery Act of 2008)

The new law makes no change to the rules that govern charitable bequests of IRA assets, either outright to charities or to deferred giving arrangements. Such transactions qualified for favorable income tax consequences in the past and will continue to be an attractive planning strategy in the future. The new law only changes the rules for lifetime charitable gifts from IRAs.

How popular were these IRA gifts in the last four months of 2006 when the law became effective? In a survey of 1,468 such gifts totaling $30 million made from IRAs administered by over 230 financial institutions, The National Committee on Planned Giving (*NCPG*) found the median gift was $5,000. Approximately 52% of the gifts were $5,000 or less and 9% of the gifts were the legal maximum of $100,000, resulting in a higher average gift size of $20,365.[2] Nearly 20% of the donors indicated that the charitable gift satisfied all or part of their minimum required IRA distribution for the year and many others cited their desire to accelerate a promised future gift or to satisfy a pledge.[3] Harvard University received 150 such IRA gifts totaling $2.5 million in 2006, with 11 (7.3%) at the maximum $100,000 level and some gifts as small as $100.[4] The University of Kansas received approximately 100 such gifts totaling $1.6 million.

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1 "Qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the provision." *Technical Explanation of H.R. 4, The "Pension Protection Act of 2006*," Joint Committee on Taxation, JCX-38-06 (August 3, 2006) at page 266. See also IRS Notice 2007-7; 2007-5 IRB 1, Q&A 42.

2 http: //www.ncpg.org/gov_relations/NCPG IRA survey--general results (1-18-07).pdf

3 *Id.*

4 Dale, Arden, "Charities Love IRA Rollovers", *The Wall Street Journal,* Jan. 27, 2007, p. B2, Col. 3.

II. Who Wins With Charitable IRA Rollover?

A. Donors who don't itemize their deductions

Probably the biggest winners under this new law are IRA owners over age 70 ½ who do not itemize income tax deductions (i.e., they take the standard deduction). Since the charitable deduction is an itemized deduction, they normally have the worst tax consequences from the gifts they make from their IRA distributions: they had to report the entire distribution as taxable income but received no offsetting income tax deduction. In theory, they should take advantage of the charitable IRA exclusion and make all of their charitable gifts from their IRAs. The primary obstacle is the practical impediment of making numerous small gifts -- e.g., \$10 or \$20 -- from an IRA. The "IRA checkbooks" offered at many brokerage houses may offer the most practical solution to this problem. Nearly two thirds of American taxpayers claim the standard deduction and the percentage is even higher for taxpayers over age 70 ½. By comparison, the new charitable IRA exclusion law gives eligible IRA donors the equivalent of an unlimited charitable income tax deduction for up to \$100,000 of the charitable gifts that they make from their IRAs.

TAXPAYERS WHO USE THE STANDARD DEDUCTION AND RECEIVE NO FEDERAL TAX BENEFIT FROM CHARITABLE GIFTS 2001 Federal Income Tax Returns

	All Taxpayers	AGI Over \$100,000	AGI Over \$200,000
Nationwide	**65%**	**9%**	**7%**
Detail on Selected States			
-- States With A State Income Tax			
California	61%	4%	2%
New York	61%	1%	1%
Ohio	65%	5%	2%
-- States With No State Income Tax			
Florida	71%	20%	19%
Texas	77%	21%	21%

Although non-itemizers are typically middle and lower income taxpayers, many are wealthy. The IRS estimates that there are 5.2 million *higher-income taxpayers* who claim the standard deduction and cannot get any tax benefit from their charitable gifts.[5] They tend to live in the nine states that do not have a state income tax: **Alaska, Florida, Nevada, New**

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5 Parisi, Michael and Hollenbeck, Scott, "Individual Income Tax Returns, 2003," *Statistics of Income Bulletin,* Internal Revenue Service, Fall, 2005, at. p. 13.

Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming. Donors (and, consequently, charities) who reside in these states will generally benefit more from the new charitable IRA exclusion law than donors who live in other states.

B. Donors Who Lose Tax Deductions As AGI (adjusted gross income) Increases.

1. The (formerly) 3% phaseout of itemized deductions. The most common lost deduction has been the phaseout of itemized deductions. The law is temporarily waived in years 2011 and 2012, but it is schedule to reappear in the year 2013. For every $100 of adjusted gross income that a taxpayer has over about $170,000 ($85,000 if married filing separately), taxpayers lose an additional $3 of itemized deductions. The phaseout had been 3% in 2005, 2% in 2006-2007, and 1% in 2008-2009 and was eliminated in 2010-2012. If it returns in the year 2013, then by keeping AGI low, donors can deduct more of their itemized deductions.

2. Phaseout of $3,650 Dependent & Personal Exemption Deductions. Wealthy taxpayers cannot claim personal exemptions for themselves or their dependents. By avoiding the recognition of IRA distributions, taxpayers in the affected thresholds may be able to deduct personal exemptions and dependent deductions. The thresholds for phaseout in 2008 begin at the following AGI levels and are phased out at the rate of 2 percent for every AGI increase of $2,500: Married Filing Jointly ($234,600), Head of Household ($195,500), Single ($156,400) and Married Filing Separately ($117,300).

3. Reduced Income Tax on Social Security Payments. If a social security recipient's modified AGI is over either $44,000 (married-joint) or $34,000 (single or head-of-household), 85% of the social security payments are taxable and 15% are tax-exempt. However, if modified AGI is under either $32,000 or $25,000, then all of the social security payments are tax-exempt. By avoiding the recognition of taxable IRA distributions an eligible social security recipient may be able to pay less tax on social security distributions. The thresholds might not apply to married individuals who live together and file separately.

4. Other Deductions That Are Phased out as AGI Increases. Other deductions that are subject to income phase-outs, and the rates of phase-out, are:

* 2% for "miscellaneous itemized deductions" (employee expense and investment expense deductions)
* 7 ½% for medical expense deductions
* 10% for nonbusiness casualty losses (e.g., damage to a vacation home)

C. Donors who live in states with a state income tax that provides no tax breaks for charitable gifts: Connecticut, Indiana, Michigan, New Jersey, Ohio, Massachusetts and West Virginia state income tax computations do not permit itemized deductions. Consequently, Indiana, Michigan, New Jersey, Ohio, Massachusetts and West Virginia residents gets no state income tax breaks from charitable gifts. Eligible donors in these states will save taxes at their highest marginal state income tax rate (e.g., 4% or 6%) for every charitable gift that they make from their IRAs instead of from their checking accounts. Although **Illinois** residents also cannot claim charitable income tax deductions, all distributions from retirement plans are exempt from the income tax so they would not see any benefit on their state returns from this new law. **Michigan and New Jersey** residents also might not see benefits since they may receive threshold amounts of retirement income exempt from state income tax and only excess amounts are subject to state taxes. The thresholds are $10,000 ($20,000 married) in New Jersey and about $40,000 ($80,000 married) in Michigan.

D. Donors who are subject to the 50% annual charitable deduction limitation. Charitable deductions cannot exceeds 50% of a taxpayer's adjusted gross income ("AGI") in any year.[6] A donor who is subject to the annual deduction limitation and who uses a taxable distribution from a retirement plan account to make an additional charitable gift would generally be able to deduct only 50% of the amount in the year of the gift. The other 50% of the distribution would be subject to income tax that year. If, instead, the charitable gift is made directly from an IRA to the charity, a donor over age 70 ½ would not pay any extra income tax.

E. Wealthy Individuals Who Want to Reduce the Size of Retirement Assets in Their Estates. Whereas most inherited stock, real estate and other assets receive a step-up in tax basis, inherited retirement distributions are generally taxed as income in respect of a decedent. The combination of estate taxes and income taxes – particularly in states that have both a state estate tax and a state income tax – can produce an effective tax rate on such inherited distributions of over 80%. Some senior citizens draw down their retirement accounts to reduce the proportion of their wealth in these assets. The charitable IRA exclusion offers an opportunity to withdraw up to $100,000 for charitable gifts without triggering some of the problems that large distributions might normally cause (e.g., the phaseout of itemized deductions and the 50% charitable deduction limitation).

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[6] Secs. 170(b)(1)(A) and (C) and Reg. Sec. 1.170A-9(e)(11)(ii). There is a 5 year carryforward for the charitable contributions that exceed 50% of AGI. Sec. 170(b)(1)(C)(ii) and last sentence of Section 170(b)(1)(B).

III. Who Doesn't Win With Charitable IRA Rollover?

A. Donors Who Are About To Sell Appreciated Stock and Appreciated Real Estate. The sale of such property will trigger a 15% federal long-term capital gains tax. This tax could be avoided by instead donating the property to a charity before the sales negotiations are finalized. The issue, then, is whether the tax savings from the charitable IRA exclusion can exceed the pending 15% tax.

Charitable gifts of appreciated stock, mutual funds and real estate have traditionally provided donors with greater income tax benefits than gifts of most other types of assets. *In most cases, gifts of these assets will continue to provide greater tax benefits than gifts from an IRA.* On the other hand, if the donor is subject to some of the tax challenges described above – such as the 50% annual charitable income tax deduction limitation -- the donor could be better off making a gift from an IRA.

> Example: Ms. Donor has a \$10,000 IRA and has stock worth \$10,000 that she bought years ago for \$2,000. She is 75 years old and has AGI of \$200,000. If she makes a charitable gift from her IRA that qualifies for the charitable IRA exclusion, she will save a little bit of money compared to receiving a taxable IRA distribution (roughly \$140, or 1.4% of the distribution, due to the phaseout of her personal exemption and the 2% loss of itemized deductions). However, she will still own her stock. If she sells the stock, she will have an \$8,000 taxable gain subject to a federal 15% capital gains tax (\$1,200). Consequently, even with the opportunity to make a tax-free charitable gift from her IRA, she should probably receive a taxable \$10,000 distribution from her IRA and contribute her stock to produce an offsetting \$10,000 charitable income tax deduction. She can use the cash from the distribution for any purpose that she chooses, including the purchase of new stock that will give her a new tax basis of \$10,000.

Compare – wealthy donors in poor health have an incentive to keep appreciated stock and to instead make charitable gifts from their IRAs: "stepped-up basis." Whereas appreciated stock will receive a step-up in basis in the hands of the beneficiaries -- generally the value at the time of death -- retirement accounts receive no step-up in basis and distributions to beneficiaries are generally taxed as ordinary income. Many individuals –especially those who are so wealthy that their estates will be subject to estate tax – consciously strive to reduce the amount of retirement assets in their estates. If they plan to hold appreciated stock until death, they may prefer to make their charitable gifts from their IRAs rather than use appreciated stock.

> Example: Ms. Donor has a \$10,000 IRA and has stock worth \$10,000 that she bought years ago for \$2,000. She loves the stock and does not think it wise to sell it. She is 75 years old, in poor health and has AGI of \$200,000 and would like to make a charitable gift of \$10,000. She should use the IRA for her charitable gift. Upon her death the stock will receive a new tax basis – i.e., about \$10,000 – and the potential capital gains tax on the \$8,000 of appreciation would be eliminated. By comparison, had she donated the stock to charity and died with \$10,000 in an IRA, the distribution to her beneficiaries would produce \$10,000 of taxable income.

B. Donors Who Reside In States Where the State Income Tax Laws Pose Problems

For example, the **Colorado**, **Kentucky** and **New York** state income tax laws exempt the first $41,000 of retirement income and also allow a charitable income tax deduction to reduce state income taxes. Consequently, a retiree who withdraws $1,000 from an IRA and then donates $1,000 to a charity usually has a tax advantage that the withdrawal was tax-free but the gift produced tax savings. Suppose that the $1,000 charitable gift was made directly from the IRA. On the state income tax return the donor would not report any taxable income but would lose the state income tax deduction and, consequently, would pay more state income tax.

C. Donors Who Would Not Receive Any Tax Savings from the Charitable IRA Exclusion and Who Encounter Administrative Hassles Trying to Make a Charitable Gift Directly from an IRA. Millions of donors won't save any income taxes with the charitable IRA exclusion. Who are they? They are donors who itemize tax deductions (and can therefore deduct charitable gifts) with incomes under $150,000 (so they are not subject to the 2% phase-out of itemized deductions) who can't realistically make social security benefits tax-exempt and who live in states that allow charitable income tax deductions. Most of these donors have not incurred a tax cost from their charitable gifts since the charitable income tax deduction has offset the taxable income from an IRA distribution. If the IRA administrator balks at making charitable grants from an IRA or has fees for the transaction, it will be much easier to simply receive a taxable distribution from an IRA and then write a check to make a charitable gift.

III. LEGAL REQUIREMENTS

A. Overview

A person over age 70 ½ who makes an outright charitable gift from her or his IRA:

(1) will not report the distribution as taxable income,[7] and
(2) will not be entitled to claim a charitable income tax deduction for the gift.[8]

B. Seven Basic Requirements

In order to make a lifetime charitable gift from an IRA without having to report the payment as a taxable distribution, the distribution must meet the definition of a "**qualified charitable distribution" (hereafter "QCD").**[9] Unless a distribution qualifies as a QCD, any lifetime charitable gift from any sort of retirement plan account (IRA, 403(b), 401(k), profit sharing, etc.) must be reported as a taxable distribution. The donor can then claim an offsetting charitable

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[7] Sec. 408(d)(8)(A).

[8] Sec. 408(d)(8)(E).

[9] Sec. 408(d)(8)(B).

income tax deduction.[10]

There are seven requirements for an IRA distribution to qualify as a QCD:

1. Donor must be at least age 70 ½. The distribution must be made on or after the date that the IRA owner attained age 70 ½.[11] In most cases such donors will be retirees. Donors under age 70 ½ will have to report charitable gifts from their IRAs as taxable distributions and can claim offsetting charitable income tax deductions if they itemize their deductions.

Tax Trap in The Year a Person Attains Age 70 ½: There can be a lot of confusion in the year that a person attains age 70 ½. All distributions that are made at any time during that year can be applied toward satisfying the minimum distribution requirement to avoid the 50% penalty tax for insufficient distributions. However, only the distributions that are made after attaining the age of 70 ½ qualify for the charitable exclusion. This can be a problem for someone who attains age 70 ½ late in the year, say on December 28. The law should be changed by a technical corrections act to conform the charitable IRA exclusion rules with the minimum distribution requirements. That is, all distributions should qualify for the charitable exclusion if made "within or after the calendar year that the individual for whose benefit the plan is maintained has attained age 70 ½". Tax administration would be simplified and innocent parties would not be caught in a tax trap.

2. IRAs only. The distribution must be made from an individual retirement plan.[12] That means only an IRA -- not a qualified retirement plan or a Section 403(b) annuity. Distributions to charities from other types of retirement accounts -- such as 403(b) plans, 401(k) plans, profit sharing plans and pension plans -- will still be treated as taxable distributions to the account owners eligible for an offsetting charitable income tax deduction.

In most cases, the restriction of such favorable tax treatment to IRAs should not pose a significant problem. Many retirees have large IRA balances because they rolled over distributions from their company retirement accounts into IRAs when they retired. Donors without IRAs who would like to take advantage of the charitable IRA exclusion can establish a new IRA and then rollover some assets from their other qualified retirement plans into the new IRA.[13]

Whereas distributions from IRAs that were once part of an SEP or a SIMPLE plan qualify for the charitable exclusion, grants made from either an *ongoing* SEP IRA or an *ongoing* SIMPLE IRA do not. Small employers often establish an SEP IRA plan or a SIMPLE IRA plan as the company's only retirement plan. The employer makes contributions to each employee's IRA

10 IRS Notice 2007-7; 2007-5 IRB 1, Q&A 43.

11 Sec. 408(d)(8)(B)(ii).

12 Sec. 408(d)(8)(B).

13 Sec. 408(d)(3). Employees who receive distributions from any type of qualified retirement account can rollover the distribution to an IRA.

rather than to the usual arrangement of a single retirement trust maintained by the employer. An SEP IRA or a SIMPLE IRA is an *ongoing* arrangement if a contribution was made to it during the year. Thus , a retired individual who has an SEP IRA or a SIMPLE IRA that received employer contributions during her or his working career can make charitable distributions from that IRA if no employer contributions were deposited in the same year as the charitable gift.[14]

3. *Directly* from the IRA to the charity.[15] The check from the IRA must be issued payable to the charity. If a check is issued from the IRA payable to the IRA owner who then endorses the check to the charity, it must be reported as a taxable distribution to the IRA owner.

Does the IRA Administrator have to mail the check to the charity? Can the check be issued payable to a charity and then mailed to the IRA account owner who then forwards the check to the charity? Yes. The IRS concluded that this arrangement would be a "direct payment" to the charity.[16] This is a very good result. The NCPG survey reported that charities received about 15% of IRA gifts from donors and 83% from IRA administrators, and that when they received checks from IRA administrators, they had difficulty identifying the correct donor 10% of the time (e.g., "$1,000 from the IRA of John Smith. Which John Smith? We have several donors with that name").[17]

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[14] IRS Notice 2007-7; 2007-5 IRB 1, Q&A 36.

[15] Sec. 408(d)(8)(B)(ii).

[16] IRS Notice 2007-7; 2007-5 IRB 1, Q&A 41.

[17] NCPG survey, at *supra* n. 2.

4. The recipient organization must be a public charity or a private operating foundation, or possibly a conduit private foundation. The recipient organization must be described in Sec. 170(b)(1)(A).[18] This statute includes most public charities as well as private *operating* foundations. **Two exceptions: donor advised funds and supporting organizations:** Although contributions to donor advised funds and Sec. 509(a)(3) supporting organizations qualify for public charity tax deductions, they are not eligible beneficiaries for the charitable IRA exclusion. In that case, the donor must report the IRA distribution as taxable income and then claim an offsetting charitable income tax deduction.[19]

Grant-making private foundations are generally excluded, except the legislation appears to permit grants from IRAs to two types of grant-making private foundations: conduit private foundations and donor-directed funds.[20] A conduit private foundation is typically a grant-making foundation that in any given year makes an election to distribute by March 15 (oversimplified) 100% of the contributions that it received that year. A donor-directed fund allows a donor to control, not just advise, the recipient of the fund's income. Private operating foundations, such as libraries and museums that are endowed by one family, are also eligible recipients.[21] However, payments to organizations that qualify for charitable income tax deductions but which are not eligible public charities – notably veterans organizations, certain fraternal organizations and cemetery companies – are not eligible for the charitable exclusion for IRA distribution.[22]

5. The payment would otherwise fully qualify for a full charitable income tax deduction.[23] A distribution will qualify as a QCD only if a person would normally be able to claim a charitable income tax deduction for the entire payment. This eliminates favorable tax treatment for IRA distributions that are used for auctions, raffle tickets, fund-raising dinners or any other type of *quid-pro-quo* transaction. If there is any financial benefit, then the entire distribution is taxable income and the donor must hope to get a partially offsetting charitable

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18 Sec. 408(d)(8)(B)(i).

19 IRS Notice 2007-7; 2007-5 IRB 1, Q&A 43.

20 Conduit private foundations are described in Sec. 170(b)(1)(A) and so therefore be eligible. Specifically, they are described in Sec. 170(b)(1)(A)(vii) and Sec. 170(b)(1)(E)(ii). Donor directed funds are described in Sec. 170(b)(1)(A)(vii) and Sec. 170(b)(1)(E)(iii).

21 Private operating foundations are described in Sec. 170(b)(1)(A)(vii) via Sec. 170(b)(1)(E)(i).

22 Charities are one of five categories of organization that are eligible to receive contributions that qualify for charitable income tax deductions: (1) governments, (2) U.S. charities, (3) veterans organizations, (4) certain fraternal organizations and (5) cemetery companies. Sec. 170(c). By comparison, only organizations described in Sec. 170(b)(1)(A) – generally public charities – are eligible for the charitable IRA exclusion.

23 Sec. 408(d)(8)(C).

income tax deduction. This eliminates the possibility that an IRA distribution will qualify as a QCD if it is used to obtain a *charitable gift annuity.*

6. Distribution would otherwise be a taxable distribution, with a maximum amount of $100,000 per year.[24] By way of background, most IRA distributions are fully taxable. However, if an IRA owner made any nondeductible contributions to the IRA, then those distributions to the IRA owner are normally tax-free. A QCD only applies to the taxable portion.

The new law provides very favorable tax treatment for outright charitable gifts from IRAs that hold non-deductible contributions. Charitable distributions are deemed to come first from the taxable portion, thereby leaving the maximum amount of tax-free dollars in the IRA.[25] An example is in the footnote.[26]

If any tax-free amounts are distributed to a charity, that portion does not qualify as a QCD. Instead, the donor is deemed to have received that amount free from income tax and can claim a charitable income tax deduction for a charitable gift of that part of the payment.

7. Donor must have documentation from the charity that would qualify the gift for a full charitable income tax deduction under normal circumstances.[27]

Part of the challenge of this new law is that the donor will have to obtain the required documentation from the charity necessary to qualify the payment for the customary charitable

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24 Sec. 408(d)(8)(B) (last sentence).

25 Sec. 408(d)(8)(D).

26 Example: An IRA owner has a traditional IRA with a balance of $100,000, consisting of $20,000 of nondeductible contributions and $80,000 of deductible contributions and accumulated earnings. Normally, 80% of a distribution to the IRA owner would be taxable and 20% would be a tax-free return of non-deductible contributions. If however, there is a distribution to a charity that qualifies as a QCD, all of the distribution is deemed to come first from the taxable portion. Thus, if the IRA trustee makes an $80,000 distribution to a charity, the entire $80,000 is deemed to come from the taxable portion of the IRA and is a QCD. No amount is included in the IRA owner's taxable income. The $20,000 that remains in the IRA is treated as entirely nondeductible contributions.

Modified from from Example 2 of *Technical Explanation Of H.R. 4, The Pension Protection Act of 2006*, Prepared by the Staff of the Joint Committee On Taxation August 3, 2006 (JCX-38-06) on page 268.

27 The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, *or if a deduction is not allowable because the donor did not obtain sufficient substantiation*, the exclusion is not available with respect to any part of the IRA distribution.*"* (Emphasis added). *Technical Explanation of H.r. 4, The "Pension Protection Act of 2006*," Joint Committee on Taxation, JCX-38-06 (August 3, 2006) at page 267."

income tax deduction.[28] That is, the charity must issue a "contemporary written acknowledgment" that describes the amount of cash contributed and that certifies that the donor did not receive any financial benefits in exchange for the gift. Failure to obtain such an acknowledgment will cause the IRA distribution to be a taxable distribution to the IRA account owner and, in the absence of the documentation necessary to justify a charitable income tax deduction, presumably might cause the person to lose an offsetting charitable income tax deduction. Many charities are "tweaking" their letters to refer to the IRA distribution, so there is less chance of confusion with other tax-deductible charitable gifts that the donor might make. For example, a letter might state "thank you for your charitable gift from your IRA of ...."

C. Technical Issues

1. How does the IRA administrator report charitable distributions to the IRS and to the IRA owner on the Form 1099-R?

For 2006 distributions, there is no special reporting responsibility for IRA administrators. Both the charitable distributions and the distributions received by the IRA owner are reported as presumably taxable distributions to the IRA owner.

2. How does the IRA owner report the charitable IRA exclusion on his or her income tax return (Form 1040)?

Since the IRA administrator does not make any distinction between charitable and non-charitable IRA distributions, the burden falls on the IRA owner to make the adjustments on his or her personal return. From a policy perceptive this is a good practice since the IRA owner is in the best position to know whether a charitable distribution in fact qualifies for the charitable IRA exclusion or not.
The IRA owner should report all of the IRA distributions on the front page on the income tax return (Form 1040 - *total distributions* on Line 15A) but should then report only the *taxable distributions* on line 15B. Source: Form 1040 instructions, page 25. Thus, the charitable IRA exclusion will be reported similarly to a traditional rollover, where a person may have received a taxable distribution from an IRA but is able to avoid taxation by rolling over the amount within 60 days to another IRA. These charitable IRA gifts will not be disclosed in any way on Schedule A, where a person claims an itemized income tax deduction for conventional charitable gifts.

Example: Mr. Smith, age 76, is required to withdraw $4,000 from his IRA in 2007 to avoid the 50% penalty for failure to take minimum required distributions after age 70 1/2. He had the IRA trustee send a $1,000 check to his favorite charity. Mr. Smith received an acknowledgment from the charity that stated that he received no personal benefit and that the entire gift qualified for a

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[28] For any gift of $250 or more, the donor must produce a "contemporary written acknowledgment" from the charity that describes the gift and that states the value, if any, of a financial benefit that the charity provided the donor. Sec. 170(f)(8). For a contribution from an IRA, there cannot be any such benefit.

charitable income tax deduction under the normal rules (such an acknowledgment is necessary for the charitable IRA exclusion). Mr. Smith personally withdrew an additional $3,000 from the IRA.

The IRA custodian will issue Form 1099-R and will report $4,000 of total distributions. Mr. Smith will report the $4,000 of total distributions on Line 15A of Form 1040 but will report only $3,000 of taxable distributions on Line 15B.[29] The $1,000 gift will not be disclosed or reported on Schedule A where Mr. Smith deducts the other charitable gifts that he made.

3. A person over age 70 ½ who is the beneficiary of an *inherited* IRA can take advantage of the charitable IRA exclusion.[30].

4. Can a charitable IRA distribution be used to satisfy a pledge? Yes. This is a very important development. The payment of a pledge from an IRA was a recurring reason donors cited for made a charitable gift from an IRA.[31]

a. No violation of IRA self dealing rules. Charitable IRA distributions can satisfy pledges without violating the IRA self-dealing prohibited transaction rules. "The Department of Labor, which has interpretive jurisdiction with respect to section 4975(d), has advised Treasury and the IRS that a distribution made by an IRA trustee directly to a section 170(b)(1)(A) organization (as permitted by section 408(d)(8)(B)(i)) will be treated as a receipt by the IRA owner under section 4975(d)(9), and thus would not constitute a prohibited transaction. This would be true even if the individual for whose benefit the IRA is maintained had an outstanding pledge to the receiving charitable organization."[32]

b. No income to the donor, even though normally there can be income when a third party pays off a person's personal liability. For a legally binding pledge (as opposed to a non-binding pledge), some people raise the argument that a donor might have taxable income if a legal liability is discharged by a third party, thereby making the donor richer. However, Section 108(e)(2) provides that a taxpayer does not have taxable income if there is a discharge of indebtedness and the payment would have been deductible. Since the payment of a pledge provides a charitable deduction, a donor should not have taxable income if a third party pays it.

5. Each spouse over age 70 ½ is eligible to contribute up to $100,000 from that spouse's IRA to eligible charities, with the maximum charitable IRA exclusion on a joint return of $200,000. The distribution must come from each spouse's respective IRA. For example, a married couple would not be able to exclude $140,000 of charitable gifts from one IRA and

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[29] See the instructions to Form 1040 at http://www.irs.gov/pub/irs-pdf/f1040.pdf

[30] IRS Notice 2007-7; 2007-5 IRB 1, Q&A 37.

[31] NCPG survey, at *supra* n. 2.

[32] IRS Notice 2007-7; 2007-5 IRB 1, Q&A 44.

$60,000 of charitable gifts from another since the $140,000 would exceed the annual $100,000 limit.[33] IRS Notice 2007-7; 2007-5 IRB 1, Q&A 34.

6. A charitable IRA distribution is not subject to withholding taxes. The IRA administrator may rely upon reasonable representations made by the IRA owner. A qualified charitable distribution is not subject to withholding under section 3405 because an IRA owner that requests such a distribution is deemed to have elected out of withholding under section 3405(a)(2). IRS Notice 2007-7; 2007-5 IRB 1, Q&A 40.

7. The exclusion applies to any such charitable distribution made during 2006, even those made before the law was enacted on August 17, 2006. IRS Notice 2007-7; 2007-5 IRB 1, Q&A 38. This may be advantageous to people who have "IRA checkbooks" (typically at brokerage houses) where they can write checks directly from an IRA. A person over age 70 ½ who wrote such a check to a qualifying charity early in 2006 can take advantage of the exclusion.

IV. CONCLUSION - An eligible IRA owner over the age of 70- ½ should attempt to make a qualified charitable distribution from an IRA if the tax savings exceed the administrative costs that the transaction might generate. For people who itemize their deductions and can claim offsetting charitable income tax deduction, it will usually be administratively easier to simply receive a check from the IRA and then make a charitable gift. However, for those individuals who do not itemize, who live in states with no charitable deduction or who otherwise benefit by keeping their AGI lower, it may be worth the effort to work with the IRA administrator to make that large charitable gift from the IRA.

[33] IRS Notice 2007-7; 2007-5 IRB 1, Q&A 34.

ANOTHER LIFETIME USE OF IRA ASSETS: A LOAN FROM AN IRA TO A CHARITY. CHARITY COULD USE LOAN PROCEEDS TO PURCHASE LIFE INSURANCE. Private Letter Ruling 200741016 (July 12, 2007). www.chirafinancialservices.com (patent application was filed)

A taxpayer proposed lending money from an IRA to a charity with a reasonable interest rate and with payment of the loan due upon his death. The charity anticipated using part of the loan proceeds to purchase a life insurance policy on the life of the IRA Owner. The Service concluded in PLR 200741016 that the IRA loan was not a "prohibited transaction" under the IRA prohibitions contained in Section 4975. Furthermore, the Service concluded that the charity's purchase of a life insurance policy was not a "prohibited investment in insurance" under Section 408(a)(3)." The IRS said there was no problem with either.

Implications: #1 Benefit from lifetime charitable use of IRA assets. by lending money from an IRA to a charity, a person can allow the lifetime use of her or his IRA assets by the charity. This can be more tax-efficient than receiving a distribution from the IRA and then donating or lending it to the charity. Except for the $100,000 provision for donors over age 70 ½ ("Charitable IRA Rollover"), usually there is taxable income from lifetime IRA withdrawals.

A charitably-inclined individual might also want to make a charitable bequest of those IRA assets to the charity at death in order to cancel the debt. Thus, instead of purchasing life insurance, this could be a great vehicle for using loan proceeds to construct a dormitory at a college or a wing at a hospital while the donor is still alive. Upon death the charity would receive its own promissory note and the debt would be canceled.

#2 – IRAs are prohibited from owning life insurance. This arrangement permits IRA dollars to indirectly be used for the purchase of insurance.

Planning tip: Probably need a self-directed IRA to do this since conventional Ira trustees and custodians usually limit investments in mutual funds, etc. and might not consent to a large loan to one charitable institution.

PLANNING FOR CHARITABLE BEQUESTS FROM RETIREMENT ACCOUNTS - MINIMUM DISTRIBUTIONS AND THE 50% PENALTY TAX

A. OBJECTIVES

The tax planning strategy that most advisors follow is to structure IRA and QRP accounts in such a way that only the smallest amounts will be required to be distributed. Smaller distributions permit greater amounts to remain in the QRP or IRA account, thereby producing greater income.

EXAMPLE: By leaving amounts in the plan, a person can have over 50% more investment income each year (e.g., $10,000 per year rather than $6,000 assuming a 10% yield, or $5,000 rather than $3,000 assuming a 5% yield, etc. etc.).

	Principal	**10% Yield**		**5% Yield**	
Amount in IRA	$100,000	10%	$ 10,000	5%	$ 5,000
Income Tax on Distribution (40%)	40,000				
Amount Left to Invest	$ 60,000	10%	$ 6,000	5%	$ 3,000

In order to force QRP and IRA accounts to be used to provide retirement income, Congress enacted two significant penalties on account beneficiaries for non-retirement uses of these assets. First, there is a 10% penalty tax for most distributions before age 59 ½.[34] Second, there is a 50% penalty tax imposed on the account owner for not receiving sufficiently large distributions after attaining the age of 70 ½ or retiring, whichever occurs later.[35] The 50% penalty tax also applies after the account owner's death to beneficiaries who fail to receive the post-death minimum amounts. Distributions from any of the qualified retirement plans, IRAs and 403(b) plans described above are potentially subject to the 50% penalty tax.

B. BASIC PLANNING STRATEGY IF A CHARITY IS A BENEFICIARY

1. Lifetime distributions – Over the account owner's lifetime the minimum distributions are generally the same whether a charity is named as a beneficiary or not. During a person's lifetime, there is no problem naming a charity as a beneficiary of part or all of the account.

2. After the account owner's death. The administrator will generally want to "cash out" the charity's share of the account before the "determination date" (September 30 of the year that follows the year that the account owner died). If the remaining beneficiaries are all "designated beneficiaries" (e.g., human beings), then the decedent's IRA can be a "stretch IRA."

34 Sec. 72(t).

35 Sec. 4974; Reg. Sec. 54.4974-2. If there is reasonable cause for the failure, the penalty can be waived. Reg. Sec. 54.4974-2, Q&A 7. In addition, a qualified retirement plan could be disqualified for failing to make the required distributions. Sec. 401(a)(9).

C. REQUIRED LIFETIME DISTRIBUTIONS AFTER AGE 70 ½

GENERAL RULES – Unless you are married to someone who is more than ten years younger than you, there is one -- and only one -- table of numbers that tells you the portion of your IRA, 403(b) plan or qualified retirement plan that must be distributed to you each year after you attain the age of 70 ½. The only exception to this table is if (1) you are married to a person who is more than ten years younger than you and (2) she or he is the only beneficiary on the account. In that case the required amounts are even less than the amounts shown in the table. To be exact, the required amounts are based on the actual joint life expectancy of you and your younger spouse.

TWO SIMPLE STEPS: **Step 1:** Find out the value of your investments in your retirement plan account on the last day of the preceding year. For example, on New Years Day -- look at the closing stock prices for December 31. **Step 2**: Multiply the value of your investments by the percentage in the table that is next to the age that you will be at the end of this year. This is the minimum amount that you must receive this year to avoid a 50% penalty.

> Example: Ann T. Emm had $100,000 in her only IRA at the beginning of the year. She will be age 80 at the end of this year. She must receive at least $5,350 during the year to avoid a 50% penalty (5.35% times $100,000).

--UNIFORM LIFETIME DISTRIBUTION TABLE –

Age	*Payout*						
70	3.65%	80	5.35%	90	8.78%	100	15.88%
71	3.78%	81	5.59%	91	9.26%	101	16.95%
72	3.91%	82	5.85%	92	9.81%	102	18.19%
73	4.05%	83	6.14%	93	10.42%	103	19.24%
74	4.21%	84	6.46%	94	10.99%	104	20.41%
75	4.37%	85	6.76%	95	11.63%	105	22.23%
76	4.55%	86	7.10%	96	12.35%	106	23.81%
77	4.72%	87	7.47%	97	13.16%	107	25.65%
78	4.93%	88	7.88%	98	14.09%	108	27.03%
79	5.13%	89	8.33%	99	14.93%	109	29.42%

Lifetime distributions are generally unaffected by who you name to be the beneficiary of your account after your death (unlike prior law). The only exception is if the sole beneficiary of your account is a spouse who is more than ten years younger than you. Other than that, the minimum lifetime distributions over the rest of your life will be the same whether you name a charity, your father, your mother, your sister, your brother, your child, your grandchild, your dog or your cat. However, distributions after your death can vary depending on who the beneficiary is. [Table computed from Table A-2 of Reg. Sec. 1.401(a)(9)-9 (2002) -- (rounded up)]

D. MAXIMUM YEARS FOR PAYOUTS AFTER ACCOUNT OWNER'S DEATH

This table contains the maximum number of years that distributions may be made from an IRA or some other type of qualified retirement plan after the account owner's death. The maximum term of years is the remaining life expectancy of either (#1) the account owner, measured by his or her birthday in the year of death, or (#2) the life expectancy of a designated beneficiary, based on that beneficiary's age at the end of the year that follows the account owner's death.

Whether the term will be #1 or #2 is determined by the identity of the beneficiaries who have not been paid in full by the "determination date" (September 30 following the year of death). The term will be based on the account owner's age (i.e., #1) if on the determination date there is any beneficiary who fails to qualify as a "designated beneficiary" (e.g., a charity or the account owner's estate). If, instead, all of the beneficiaries are designated beneficiaries, then the payout is determined by the age of the oldest designated beneficiary (i.e., #2).

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	82.4	20	63.0	40	43.6	60	25.2	80	10.2
1	81.6	21	62.1	41	42.7	61	24.4	81	9.7
2	80.6	22	61.1	42	41.7	62	23.5	82	9.1
3	79.7	23	60.1	43	40.7	63	22.7	83	8.6
4	78.7	24	59.1	44	39.8	64	21.8	84	8.1
5	77.7	25	58.2	45	38.8	65	21.0	85	7.6
6	76.7	26	57.2	46	37.9	66	20.2	86	7.1
7	75.8	27	56.2	47	37.0	67	19.4	87	6.7
8	74.8	28	55.3	48	36.0	68	18.6	88	6.3
9	73.8	29	54.3	49	35.1	69	17.8	89	5.9
10	72.8	30	53.3	50	34.2	70	17.0	90	5.5
11	71.8	31	52.4	51	33.3	71	16.3	91	5.2
12	70.8	32	51.4	52	32.3	72	15.5	92	4.9
13	69.9	33	50.4	53	31.4	73	14.8	93	4.6
14	68.9	34	49.4	54	30.5	74	14.1	94	4.3
15	67.9	35	48.5	55	29.6	75	13.4	95	4.1
16	66.9	36	47.5	56	28.7	76	12.7	96	3.8
17	66.0	37	46.5	57	27.9	77	12.1	97	3.6
18	65.0	38	45.6	58	27.0	78	11.4	98	3.4
19	64.0	39	44.6	59	26.1	79	10.8	99	3.1

Table A-1 of Reg. Sec. 1.401(a)(9)-9 ("single life "), required by Reg. Sec. 1.401(a)(9)-5, Q&A 5(a) & 5(c) and Q&A 6.

E. REQUIRED DISTRIBUTIONS AFTER DEATH-- Terminology

Required Beginning Date ("RBD") - The first date that a distribution must be made from an IRA, QRP or 403(b) account to the account owner in order to avoid the 50% penalty tax.[36]

IRAs**:** The RBD for an IRA is April 1 following the calendar year that the IRA account owner attains age 70 ½.[37]

QRP or 403(b): The RBD for a qualified retirement plan or a tax-sheltered annuity is the *later* of (a) April 1 following the calendar year that the account owner attains age 70 ½ or (b) April 1 following the calendar year that the employee separates from service (e.g., somebody who works past age 71).[38] Individuals who own 5% or more of a business are not eligible for this later RBD: their RBD is April 1 following the calendar year that they attain age 70 ½.

"Beneficiaries" versus "Designated Beneficiary" ("DB") - A beneficiary is any person or entity that is entitled to receive benefits from a QRP or IRA account after the account owner's death. By comparison, a *designated beneficiary* is an individual who is entitled to the benefits of the IRA or QRP account upon the death of the employee / participant / IRA owner (hereafter "account owner").[39] Neither a charity nor the decedent's estate will qualify as a DB since neither has a life expectancy. If certain criteria are met, a trust may be the beneficiary of an IRA or QRP and distributions will be based on the beneficiaries of that trust (a "look-through trust").

Determination Date - The date when the beneficiaries must be determined is September 30 of the calendar year that follows the calendar year of the account owner's death.[40] Example: Sarah died on June 15, 2010, the determination date for her IRA and QRP accounts will be September 30, 2011. The minimum distributions will be computed based only on the beneficiaries who still have an interest on the determination date. If a beneficiary's interest is eliminated between the time that the account owner died and the determination date – for example by a cash out or a disclaimer -- then that beneficiary will not impact the required minimum distributions. PLR 200740018 (July 12, 2007).

There are basically three ways to eliminate some of the beneficiaries before the determination date: (1) disclaimers, (2) cash-out of a beneficiary and (3) separate accounts for different beneficiaries.

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36 Sec. 4974; Reg. Sec. 54.4974-2, Q&A 1 and 2.

37 Sec. 408(a)(6); Reg. Sec. 1.408-8 Q&A 3.

38 Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-2, Q&A 2.

39 Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-4, Q&A 1.

40 Reg. Sec. 1.401(a)(9)-4, Q&A 4.

F. DISCLAIMERS -- What happens when a person disclaims an interest in an inherited retirement plan account? That is, upon the employee's death, the primary beneficiary makes a "qualified disclaimer" within the applicable 9 month period so that the property passes to a contingent beneficiary, such as a charity. *The IRS will allow a primary beneficiary to disclaim all or part of an inherited retirement account even if he or she received a mandatory distribution from the account in the year of the account owner's death.* Rev. Rul.2005-36, 2005-26 IRB 1368 (by comparison, any acceptance of benefits will normally disqualify a disclaimer). The estate can then claim an estate tax charitable deduction for the amount that was transferred to a charity by way of the disclaimer.[41]

> EXAMPLE WITH A CHARITY: Assume that Mother's estate is comprised of a $1.1 million retirement account and $1 million of other assets. Mother named Daughter as the primary beneficiary and named Charity as a contingent beneficiary of her retirement account. Upon Mother's death, Daughter could make a qualified disclaimer of just $100,000, generating a $100,000 charitable estate tax deduction. Mother's taxable estate would be just $2 million, thereby avoiding the estate tax. . Daughter would not have to recognize any taxable income nor would she be treated as having made a gift.[42]

CAUTION #1: Disclaimers of property that pass to a ***private foundation*** pose tax problems. A solution that has been approved by the IRS is to make a disclaimer to a ***donor advised fund*** of a community foundation rather than a private foundation. [43]

CAUTION #2: Generally avoid this strategy for transferring assets to a *charitable remainder trust*. A person (except for a surviving spouse) cannot make a valid disclaimer to a trust if he or she will also be a beneficiary of that trust.[44]

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41 Reg. Section 20.2055-2(c)(1).

42 Rev. Rul.2005-36, 2005-26 IRB 1368

43 A problem exists if a parent names a child as a beneficiary of an estate and through the child's disclaimer the property passes to a private foundation where the child is a director. The child's participation in the private foundation's selection of charitable grant recipients could prevent the disclaimer from being a qualified disclaimer. This is because the child would be normally involved in selecting the ultimate charitable beneficiaries of the private foundation, which could violate the requirement that the interest in property passes "without any direction on the part of the person making the disclaimer." Reg. Sec. 25.2518-2(d)(1) & (2); 25.2518-2(e)(1)(I). *One solution* to deal with this is for the private foundation to amend its bylaws so as to prohibit the child and the child's spouse from participating in the selection of grant recipients from amounts that are attributable to the disclaimed property. See PLRs 200649023 (Aug. 23, 2006), 9317039 (Feb. 2, 1993) and 9141017 (July 10, 1991). This is a fairly clumsy solution that interferes with a parent's desire to allow children to be involved with a private foundation. *A better solution* may be to have a child disclaim property to an advised fund of a community foundation. The IRS concluded that the advisory nature of a child's or grandchild's grant recommendations did not pose a problem. PLRs 200518012 (Dec. 17, 2004) (disclaimers by grandchildren) and PLR 9532027 (May 12, 1995) (disclaimers by children).

44 Reg. Sec. 25.2518-2(e)(3).

G. REQUIRED DISTRIBUTIONS AFTER DEATH FOR PEOPLE WHO DIE AFTER "THE REQUIRED BEGINNING DATE" (the "*stretch IRA*"*)

[What follows is a bare-bone basics for the typical situation of someone over the age of 71 who would like to make a bequest of an IRA in part to a charity and in part to a younger person, such as a child. The regulations should be examined in detail for more complicated situations (e.g., a trust is a beneficiary, contingent beneficiaries, etc.)]

*RULES IF SPOUSE IS NOT A DESIGNATED BENEFICIARY (*Spouses generally qualify for the most favorable treatment, such as rollovers). GENERAL RULE The general rule is that distributions can be extended over the life expectancy of a person who is the same age as the account owner in the year of death. This applies if there is no "designated beneficiary" -- i.e., no individual. Reg. Sec. 1.401(a)(9)-5, Q&A 5(c)(1). For example, if the beneficiary is a charity or the decedent's estate there is no "designated beneficiary."

EXAMPLE: Sam died at the age of 79 and named a 15 year charitable lead trust as the beneficiary (payments to a charity for 15 years, then remainder to his granddaughter who is currently 19 years old). His IRA must be emptied over the next 11 years, since a 79 year old person has a life expectancy of nearly 11 years. The minimum required for each year is 1/11th the first year, 1/10th the second year, 1/9th the third year, and so on (oversimplified).

EXCEPTION IF THERE IS A YOUNGER DESIGNATED BENEFICIARY

Instead of distributing the amounts over the life expectancy of someone who is the decedent's age, amounts can be distributed over the longer life expectancy of a younger designated beneficiary. The life expectancy of the designated beneficiary is determined by using the beneficiary's age as of the beneficiary's birthday in the calendar year immediately following the calendar year of the account owner's death. Reg. Sec. 1.401(a)(9)-5, Q&A 5(c)(1).

EXAMPLE: When Sam died at the age of 79 he had named his 19 year old granddaughter as the sole beneficiary of the IRA. The year after his death, his granddaughter attained age 20. According to the life expectancy tables, a 20 year old has a life expectancy of 63 years. Thus, instead of distributing the amounts over 11 years, the amounts can be distributed over 63 years. The first required distribution is 1/63rd, next year it is 1/62nd, etc. etc.

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* The term "stretch IRA" usually refers to an IRA where, after the original account owner's death, the distributions from the IRA are stretched over the life expectancy of the designated beneficiary (e.g, a grandchild). As a practical matter, most planning focuses on IRAs rather than company retirement plans or even 403(b) plans, despite the fact that the laws on minimum lifetime and testamentary distributions are basically the same for all these plans. Many companies choose to distribute account balances in full upon an employee's retirement or death to eliminate the burden of maintaining the account, even though the tax laws permit distributions to occur over a much longer time period. By comparison, banks and mutual funds that administer IRAs are generally very willing to administer the accounts for extended time periods.

OBSERVATION: If there is a designated beneficiary who is *older* than the account owner, then the account can be distributed based on the life expectancy of someone who was the same age as the account owner rather than over the shorter remaining life expectancy of the older designated beneficiary. EXAMPLE: When Sam died at the age of 79 he had named his 85 year old sister as the sole beneficiary of the IRA. Next year his sister was age 86. The mandatory distributions are based on the remaining life expectancy of a 79 year old (rather than an 85 or 86 year old) determined in the year of Sam's death (rather than in the subsequent year). Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)(1).

WHAT IF THERE ARE TWO OR MORE BENEFICIARIES? Generally the distributions are measured by the beneficiary with the shortest life expectancy. Reg. Sec. 1.401(a)(9)-5, Q&A 7(a)(1). However, separate distribution computations may be possible with separate accounts. Reg. 1.401(a)(9)-8, Q&A 2 & 3.

EXAMPLE: Sam named both his 58 year old nephew and his 22 year granddaughter as equal co-beneficiaries. Distributions to both beneficiaries are based on the older nephew's life expectancy (i.e., of someone who is age 59 following the year of death). However, separate distribution computations may be possible with separate accounts for each beneficiary.

WHAT IF ONE BENEFICIARY IS A CHARITY? GENERAL RULE: The minimum distributions revert to the decedent's remaining life expectancy. The other beneficiaries (e.g., children and grandchildren) cannot use their longer life expectancies. The logic is that a charity does not have a life expectancy. Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)(2) and 5(c)(3).

SOLUTIONS WHEN A CHARITY IS A BENEFICIARY:

#1: CASH OUT THE CHARITY's INTEREST BEFORE SEPTEMBER 30 OF THE NEXT YEAR: If the charity's entire share is distributed before September 30 of the calendar year that follows the year of death, then the charity is no longer a beneficiary and will not affect the distribution period. This is because the point in time when the final beneficiaries are determined is September 30 of the calendar year following the calendar year of the account owner's death. Reg. Sec. 1.401(a)(9)-4, Q&A 4(a); PLR 200740018 (July 12, 2007).

#2: SEPARATE ACCOUNT FOR THE CHARITY: Reg. Sec. 1.401(a)(9)-8, Q&A 2 and 3. In that case, the distributions to the other beneficiaries are computed without regard to the account for the charity. For an example of separate payout streams when an IRA was payable to a trust that provided 10% for charities and 90% for family, see PLR 200218039 (Feb. 4, 2002) (using the 1987 proposed regulations).

III. OVERCOMING OBSTACLES FOR CHARITABLE BEQUESTS FROM IRAs and QUALIFIED RETIREMENT PLANS

A. INTRODUCTION

There are several obstacles to make a charitable bequest of IRD or a distribution from a qualified retirement plan account. They can be divided into the following categories:

(1) Problems with the income tax return of the estate (Form 1041)
(2) Problems with the mandatory distribution rules from QRPs and IRAs, and
(3) Problems if IRD is transferred to a charitable remainder trust and there is estate tax due (the formula: *IRD + CRT + Estate Tax = Problem*)
(4) Other miscellaneous problems (e.g., require consent of surviving spouse for charitable bequest from company retirement plan (but not an IRA), avoid pooled income funds, etc.)

B. AVOID PROBLEMS ON ESTATE'S INCOME TAX RETURN

1. The Income Tax Nightmare: An estate or a trust has taxable income from receiving taxable retirement plan distributions or other sources of IRD, but it cannot claim an offsetting charitable income tax deduction when that income is distributed to a charity.

IRS Chief Counsel Memorandum ILM 200848020 (July 28, 2008) is a dramatic illustration of how a charitable bequest of IRD can go wrong. The decedent had left his IRA to a trust that benefitted his six children and several charities. The trust received distributions from the IRA for the charitable shares and the trustee immediately paid these amounts to the charities, leaving the six children as the only remaining beneficiaries of the trust. The IRS Chief Counsel's office concluded that the trust had taxable income from the IRA distribution but was not entitled to claim an offsetting charitable income tax deduction since the trust instrument contained no instructions to distribute income to a charity.

2. Basic Strategy – There is generally a two-prong planning strategy to avoid problems on the estate's income tax return if IRD will be transferred to charity:

(1) try to keep the IRD off of the estate's income tax return, and

(2) in the event some IRD is reported by the estate, then have the estate qualify for a charitable income tax deduction for the payment to the charity.

3. Keeping the Income Off of The Estate's Income Tax Return

a. IRAs and Qualified Retirement Plans: *Focus On The Beneficiary Designation Forms Rather Than the Will.*

The largest source of IRD will usually be an IRA or a QRP, which is a separate trust that is not governed by the will or by the decedent's trust instrument. IRA and QRP assets do not pass through probate, unless the owner made the mistake of naming the probate estate as the beneficiary of these assets. Instead, these assets are transferred directly to the beneficiary who is named as the successor beneficiary on the forms provided by the retirement plan.

If the assets are to be transferred to a charity or a charitable remainder trust, *usually you will want to avoid naming the estate as a beneficiary. Instead the charity or charitable remainder trust should be named as a beneficiary.* That way the estate will not have to report any income on the estate's income tax return since the estate would not be legally entitled to any amount from the retirement plan. Reg. Sec. 1.691(a)-2(a)(2). Of course, if the income is not reported on the estate's income tax return, there is no corresponding income tax charitable deduction either. Reg. Sec. 1.642(c)-3(b). See the next pages for solutions if the estate was named as the beneficiary.

b. Conventional IRD Assets: *#1: Require "In Kind Distributions" To Charity*

An in-kind distribution is a distribution of a particular asset to a specific beneficiary. In order to make an in-kind distribution of IRD assets, the will can contain instructions that specific IRD assets will be given to specific charities. For example, the will could state: "all of my installment sale notes shall become the property of the Christopher R. Hoyt tax-exempt charitable remainder trust; all of my savings bonds shall become the property of charity XYZ etc."

In that case, the estate will distribute the IRD asset to the charity or CRT and it, rather than the estate, will recognize income from the IRD. Sec. 691(a); Reg. Sec. 1.691(a)-4(b)(2); Rev. Rul. 64-104, 1964-1 C.B. 223; see also PLRs 200002011 (Sept. 30, 1999) and 200012076 (Dec. 29, 1999) (bequests of employee stock options). If the recipient is a tax-exempt public charity or charitable remainder trust, no tax will be due. If savings bonds are redeemed by a private foundation, it will be liable for the 2% excise tax on the interest income. Rev. Rul. 80-118, 1980-1 C.B. 254).

c. Conventional IRD Assets (and IRAs!): *#2: Give the trustee/executor discretion to make non-pro rata distributions of IRD assets*

A non-pro rata distribution is when the assets of an estate are not proportionately divided among the beneficiaries of an estate but, instead, one beneficiary receives proportionately more or less of a particular asset. For example, suppose that a decedent had $100,000 of savings bonds (an IRD asset) at the time of his death and that his will instructed the executor to divide his $400,000 estate equally among his three children and his favorite charity. With a pro-rata distribution, each child and the charity would receive $25,000 of savings bonds. If the executor did not have the power to make a pro-rata distribution and simply gave all $100,000 of savings bonds to the charity, the IRS would conclude that there had been a taxable exchange among the beneficiaries. Rev. Rul. 69-486, 1969-2 C.B. 159. However, if either the will or state law gives an executor discretion to make non-pro rata cash or in-kind distributions, then there may be no taxable income when the executor distributes all of the savings bonds to a charity and all of the non-IRD assets to the children. Private Letter Ruling 9537011 (June 16, 1995).

The IRS permits executors to assign a decedent's IRAs, 403(b) accounts and deferred annuity contracts to charities under similar circumstances. The decedent had named the *estate* as the beneficiary of his retirement accounts and had made charitable bequests. Because the will authorized the executor to use any asset for any distribution, the IRS concluded that the executor could "assign" the retirement accounts to charity. Neither the estate nor any other beneficiary would have to report any taxable income when the distributions were made to the charities. Private Letter Rulings 200633009 (May 16, 2006) (***IRAs*** where *residue* of estate to go to charity; executor had power to "make distributions ...either pro-rata or otherwise"); 200850004 (Sep. 8, 2008) (probate court specifies that ***IRAs*** payable to the estate should be the source of payment for the share of the estate allocable to charities); 200845029 (July 10, 2008) (***defined benefit plan*** payable to estate where *residue* of estate is payable to charities); 200826028 (Mar. 27, 2008)(*residue* of trust payable to charities and trust instrument permits in-kind distributions); 200652028 (Sep 13, 2006) (***IRAs*** where *residue* of estate was left to a charity); 200618023 (Jan 18, 2006) (***annuity contracts*** assigned to charitable residuary beneficiaries when *state law,* rather than the will, permitted non-pro rata distributions), 200617020 (Dec 8, 2005) (***IRA*** where *residue* of estate was left to a charity), 200511174 (Feb 8, 2005) (***IRAs & 401(k) plan*** where *residue* of estate was left to charity); PLR 200526010 (Mar. 22, 2005) (***IRAs*** payable to ***trust*** with charitable residue); 200452004 (Aug. 10, 2004) (***IRAs*** and ***deferred annuity contracts*** to charitable *residuary*) and 200234019 (May 13, 2002) (***IRAs*** and ***403(b) accounts*** where ***portion*** of the estate went to charity).

d. But Don't Satisfy A Charitable Pecuniary Bequest With Retirement Assets

The IRS Chief Counsel concluded that satisfying a pecuniary charitable bequest with an IRA will trigger taxable income to the estate. The memorandum also stated that the trust could not claim an offsetting charitable income tax deduction since the decedent's trust instrument contained no instructions to pay any income to charities. ILM 200644020 (Dec. 15, 2005 -- released to the public in November, 2006). Until this controversy is resolved, it would be best to avoid satisfying pecuniary bequests with retirement accounts. Furthermore, as a precaution it would be helpful to draft wills and trusts so that an offsetting charitable income tax deduction could be claimed (see next page).

The Chief Counsel memorandum addressed a situation where a decedent's IRA was payable to a trust that provided for specific pecuniary bequests to three different charities. The trustee had the power to distribute any asset to any charity, so the trustee instructed the IRA custodian to divide the IRA into shares "each titled in the name of a beneficiary under Trust. Thus, each of the charities became the owner and beneficiary of an IRA equal in value, at the time of division, to the dollar amount it was entitled to under Trust." That way the trust satisfied the pecuniary bequests by distributing the IRAs from the trust to the charities, and then the IRAs would make cash distributions to the charities at a future time.

The drafter of the memo concluded that the trust had taxable income when the IRA was used to satisfy the pecuniary bequest and that the trust would not be entitled to an offsetting charitable income tax deduction. The drafter indicated that the employee plan division of the IRS did not object to the conclusion.

Natalie Choate, one of the nation's premier authorities in the area of taxation of employee benefits, concludes that the Service may be correct if a trustee has the power to pick and choose which asset to give to a pecuniary beneficiary and then selects a retirement account. By comparison, she concludes that when there is no discretion – for example when there is a pecuniary marital formula and an estate that is top-heavy with retirement assets must use some of those assets to satisfy the formula – she believes that one can avoid a taxable gain. See Steve Leimberg's Employee Benefits and Retirement Planning Newsletter # 393 (December 5, 2006) at http://www.leimbergservices.com. The IRS had issued several private letter rulings in the 1990s in which there was no hint of taxable income when IRAs payable to estates were used for *marital trusts funded with pecuniary formulas*. PLRs 9524020 (June 16, 1995), 9608036 (Feb. 23, 1996), 9623056 (June 7, 1996) and 9808043 (Feb 20, 1998). For analysis of these marital trust rulings and disclaimer strategies for pecuniary amounts in marital and credit shelter trusts, see Choate, "Assignment of the Right-To-Receive IRD", *Life and Death Planning for Retirement Benefits* (5th ed. 2002), Section 2.2.06, pages 92-94.

4. Allow the Estate to Claim a Charitable Income Tax Deduction In The Event IRD Is Recognized By The Estate

a. Drafting the Will or the Trust Instrument >> *Very important: The will or living trust should contain instructions that all charitable bequests should be made, to the extent possible, with IRD assets.* Every will and living trust that provides for a charitable bequest should probably contain language along the following lines:

> "I instruct that all of my charitable gifts, bequests and devises shall be made, to the extent possible, from property that constitutes "income in respect of a decedent" as that term is defined under the U.S. income tax laws, and shall qualify for the charitable income tax deduction under Section 642(c)(5) or any corresponding section of any future Internal Revenue Code."

Without such language an estate will not be able to claim either a charitable *income* tax deduction nor a *DNI* deduction for a distribution of principal to a charity (e.g., a typical charitable bequest). Rev. Rul. 2003-123, 2003-50 IRB 1200, citing *Crestar Bank (Estate Of James A. Linen) v. IRS*, 47 F Supp 2d 670 (E.D. Virginia, April, 1999); *Van Buren v. Commissioner*, 89 T.C. 1101 (1987); and *Riggs National Bank v. U.S.*, 352 F. 2d 812 (Ct. Cl. 1965). See also IRS Chief Counsel Memorandum ILM 200848020 (July 28, 2008). This is because Sec. 642 imposes a "tracing" requirement for charitable income tax deductions of estates: the source of the contribution must be traced to the estate's income. The requirement is usually met when, for example, the governing instrument requires income to be distributed to a charity.

With this language, there is a good argument that if an estate has any income from IRD, then the estate can claim on offsetting charitable income tax deduction for the payment that was made to charity or the total amount of IRD, whichever is less. Rev. Rul. 83-75, 1983-1 C.B. 114.

Since IRD could be subject to two taxes (both the estate tax and the income tax), then when IRD is required to be distributed to a charity and is in fact so distributed, the estate should be entitled to claim both an estate tax deduction and an income tax charitable deduction for the same charitable gift.

Caution: a 2008 proposed tax regulation provides that when a governing instrument specifies a source of income (such as IRD) to be used for a charitable income tax deduction, the instructions must have an economic effect independent of income tax consequences in order to be respected.

The proposed rule is that "a provision in the governing instrument ... that specifically provides the source out of which amounts are to be paid ... for such a [charitable] purpose controls for Federal tax purposes to the extent such provision has economic effect independent of income tax consequences." See the proposals to modify Reg. Sections 1.642(c)-2(b) and 1.643(a)-5(b) contained in REG-101258-08, 2008-28 I.R.B. 111 that was also published in the Federal Register on Wednesday, June 18, 2008 (73 FR 34670).

This suggests that instructions to use IRD for certain charitable dispositions might not be respected unless those dispositions had an independent economic effect. For example, there is no independent economic effect if a will provides for a $100,000 charitable bequest and specifies that it should be "paid from IRD, if any exists." The charity will receive $100,000 whether there is any IRD or not.

On the other hand, what are the sanctions for failure to have an independent economic effect? The proposed regulations merely address the division of an estate's or trust's taxable and tax-exempt income amongst income beneficiaries, some of which include charities. They do not address whether a charitable income tax deduction will be allowed, denied or partially allowed/denied when a governing instrument contains instructions that all charitable bequests must be satisfied with IRD whenever that is possible.

If instructions to use a specific source of income (such as IRD) for a charitable income tax deduction do not have an independent economic effect, then the proposed regulation states that the estate's or trust's income will instead be allocated between charitable and non-charitable beneficiaries using the same proportionate ratio of all classes of income of the estate or trust. Such a result wouldn't impose a hardship as long as the estate or trust could still claim a charitable income tax deduction. It wouldn't matter that the deduction was comprised of a mix of interest, dividends and IRD. "In the absence of such specific provisions in the governing instrument or in local law, the amount to which section 642(c) applies is deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes." Prop. Reg. Sec. 1.642(c)-3(b)(2).

What clauses have a substantial economic effect?

Pay to charity XYZ all of the taxable retirement plan distributions that my estate receives.

Pay the first $300,000 of the taxable retirement plan distributions that my estate receives to *charity ABC, and the rest of these distribution to my son, Jacob.*

These clauses have a substantial economic effect because the charity will only receive amounts if the estate indeed receives taxable retirement plan distributions. Furthermore, these clauses could "disinherit" other beneficiaries from receiving any or all retirement distributions payable to an estate. Hence, the clauses have an economic effect.

What clauses do <u>not</u> have a substantial economic effect?

Example: Divide the income of my estate equally between Charity and my daughter, but when you report the distributions to the beneficiaries, you should allocate all of the tax-exempt income from municipal bonds to my daughter and none of that income to Charity.

This does not have economic effect. For example, if an estate had $40,000 of tax-exempt municipal bond income and $60,000 of taxable interest (total of $100,000 of income), the estate would distribute $50,000 apiece to the Charity and to daughter. Beyond income tax savings, what is the economic effect of allocating all $40,000 of tax-exempt interest to the daughter? There is nothing in this provision that changes each beneficiary's entitlement from the original $50,000 distribution. Thus, the regulations would instead conclude that only $20,000 of daughter's income was from the municipal bond interest and the remaining $20,000 of such tax-exempt interest was distributed to the charity.

By comparison, if the clause stated: *First pay all municipal bond interest to my daughter and then divide the remaining income equally between Charity and my daughter*, then there would be an economic effect. Daughter would receive $40,000 and then half of the remaining $60,000, which would reduce the Charity's distribution from $50,000 to $30,000, thereby having an economic effect.

b. Strategies if the Will or the Trust Instrument Does Not Contain Such Language. – If the will or trust instrument does not include instructions that charitable bequests should be made with IRD, there may be ways to administer the estate so that the taxable income from IRD assets will be directed to charities. First, if the will or trust authorizes non-pro rata distributions, an executor may be able to "assign" the IRAs to the charities so that the estate does not have to recognize any income. See the private letter rulings cited on the preceding pages.

Another strategy is to pay the charities last. This works best when the *residue of the estate will be paid to charities* following specific bequests to individuals. Also assume that the individual named his estate as the beneficiary of his IRA. In Year 1, the executor could pay most administrative expenses and all of the specific bequests to the individuals, leaving the charity as the only remaining beneficiary at the end of Year 1. Then in Year 2 the estate could receive the entire IRA. Under these facts, the IRS concluded that an estate was entitled to a charitable set-aside income tax deduction that would offset the taxable income from the IRA. PLRs 200221011 (Feb. 12, 2002) and 200336030 (June 3, 2003) (**IRAs** and ***savings bonds***); PLR 200526010 (Mar. 22, 2005) (IRAs and ***savings bonds***); PLR 200537019 (May 25, 2005) (***annuity contracts***).

IV. LEGAL AUTHORITY ON POINT

1. CHARITABLE BEQUESTS FROM IRAs AND QUALIFIED PLANS

a. General Principles Neither the donor's estate nor heirs will recognize taxable income if the retirement plan / IRA proceeds are paid directly to the charity or to a charitable remainder trust. PLR 200826028 (Mar. 27, 2008), 200652028 (Sep 13, 2006); 200633009 (May 16, 2006), 200618023 (Jan 18, 2006), 9723038 (March 11, 1997) (public charity); PLRs 9838028 and 9818009 (private foundation); PLRs 9901023 (Oct. 8, 1998) and 9634019 (May 24, 1996) (charitable remainder trust). If, instead, the plan proceeds are paid to the estate, the estate may be able to claim an offsetting charitable income tax deduction if the residue of the estate will be paid to charity. PLRs 200526010 (Mar. 22, 2005), 200336020 (June 3, 2003) and 200221011 (Feb. 12, 2002). The executor may also be able to "assign" IRAs to charities to satisfy charitable bequests (see **"**c. Transfers to a Public Charity" below).

b. Transfers to a Private Foundation PLRs 199939039 (June 30, 1999), 9838028 (June 21, 1998), 9818009 (Jan. 8, 1998), 9341008 (July 14, 1993) & 9633006 (May 9, 1996): Transfers to private foundations; neither estate nor beneficiaries have any taxable income when IRA goes to private foundation; no 2% Sec. 4940 p.f. investment income tax on distribution from retirement plan, but yes there is 2% tax on distribution from annuity contract. PLRs 200425027 (Feb 27, 2004) and 9826040 (March 30, 1998). No "self dealing" private foundation tax if private foundation is required by terms of living trust to pay to the estate "IRD" assets in order to pay recomputed estate tax.

c. Transfers to a Public Charity - ***Assign to a charity the IRAs that were <u>originally payable to the estate or to a testamentary trust.</u> The estate or trust has no taxable income.*** - PLRs 200850004 (Sep. 8, 2008) (probate court specifies that *IRAs* payable to the estate should be the source of payment for the share of the estate allocable to charities); 200845029 (July 10, 2008) (*defined benefit plan* payable to estate where *residue* of estate is payable to charities); 200826028 (Mar. 27, 2008)(*residue* of trust payable to charities and trust instrument permits in-kind distributions); 200652028 (Sep 13, 2006) (*IRAs* where *residue* of estate was left to a charity); 200633009 (May 16, 2006) (*IRAs* where *residue* of estate to go to charity; executor had power to "make distributions in cash, in kind or partly in each, either pro-rata or otherwise"); 200617020 (Dec 8, 2005) (*IRA* where *residue* of estate was left to a charity), 200511174 (Feb 8, 2005) (*IRAs & 401(k) plan* where *residue* of estate was left to charity), PLR 200526010 (Mar. 22, 2005) (*IRAs* with charitable residue); PLR 200452004 (Aug. 10, 2004) (*IRAs* and *deferred annuity contracts* where the *residue* of estate was left to charity) and PLR 200234019 (May 13, 2002) (*IRAs* and *403(b) accounts* where *a portion* of the estate went to charity). Also PLR 200618023 (Jan 18, 2006) (*annuity contracts* assigned to charitable *residuary* beneficiaries under applicable *state law* rather than the will). Decedent's estate was named as the beneficiary of IRAs, 401(k) plan, 403(b) accounts and annuity contracts. Decedent's will (or the governing state law) permitted the executor to use any asset for any bequest. IRS allowed the executor to "assign" the IRAs and 403(b) accounts to charities so that neither the estate nor other beneficiaries had to recognize any taxable income when the retirement accounts made their distributions to the charities. Danger: see "d" below for paying a fixed dollar bequest (i.e., pecuniary amount).

PLR 200218039 (Feb. 4, 2002) – Deceased's IRA was payable to a trust where 90% was allocated to family members and the remaining 10% was to be paid to charities (to be chosen by the deceased's children) after the surviving spouse's death. A court reformed the trust so that the 10% charitable share would not affect the 90% payout to family under the mandatary IRA distribution rules (using the 1987 proposed regs).

PLR 200052006 (Sept. 25, 2000) - Sister was named as the beneficiary of decedent's IRAs and there were no contingent beneficiaries. However, decedent's will provided that charitable bequests should be made from the IRAs. Sister disclaimed her interest in the IRAs so that IRAs went to decedent's estate and then, through additional disclaimers, went to charities. Estate receives estate tax charitable deduction.

PLR 9723038 (March 11, 1997): Transfer to public charity that paid the 15% penalty tax of the estate (the 15% penalty tax was repealed later in 1997).

d. Satisfying A Pecuniary Bequest With Retirement Assets -- Triggers income to an estate or trust and there is no offsetting charitable income tax deduction unless there are instructions in the document to leave income to charity. The IRS Chief Counsel concluded that satisfying a pecuniary charitable bequest with an IRA will trigger taxable income to the estate. The memorandum also stated that the trust could not claim an offsetting charitable income tax deduction since the decedent's trust instrument contained no instructions to pay any income to charities. ILM 200644020 (Dec. 15, 2005). This ruling comes as a surprise since the IRS had issued several private letter rulings in the 1990s in which there was no hint of taxable income when IRAs payable to estates were used for *marital trusts funded with pecuniary formulas*. PLRs 9524020 (June 16, 1995), 9608036 (Feb. 23, 1996), 9623056 (June 7, 1996) and 9808043 (Feb 20, 1998).

e. If a testamentary trust has both family and charitable beneficiaries, if the trust pay off charities before September 30 following the year of death, the remaining family members can receive *stretch IRA* distributions over their remaining life expectancies. PLR 200740018 (July 12, 2007). An IRA was payable to a trust to benefit cousins for life. There was also a pecuniary bequest to a charity. The charity received the entire amount before Sept 30 following the year of the IRA owner's death. The IRS concluded that the charity was no longer considered a beneficiary of the trust and that the IRA could make distributions to the trust based on the life expectancy of oldest cousin. The IRS did not rule on whether the trust could claim a charitable income tax deduction for the charitable payments.

Can such a trust or estate claim a charitable income tax deduction to offset taxable IRA distributions that are immediately distributed to charities? If a trust does not have instructions to pay income to charity, the IRS holds that there is no offsetting charitable income tax deduction. See IRS Chief Counsel Memorandum ILM 200848020 (July 28, 2008). It addressed a situation where the decedent had left his IRA to a trust that benefitted his six children and several charities. The trust received distributions from the IRA for the charitable shares and the trustee immediately paid these amounts to the charities, leaving the six children as the only remaining beneficiaries of the trust. The IRS Chief Counsel's office concluded that the trust had taxable income from the IRA distribution but was not entitled to claim an offsetting charitable income tax deduction since the trust instrument contained no instructions to distribute income to a charity. By comparison, when the *residue or remainder of an estate or trust* is payable to charity, it is possible to claim an offsetting charitable income tax deduction. Please see above *"c. Transfers to a Public Charity - Assign to a charity the IRAs that were originally payable to the estate or to a testamentary trust.*"

The ability of an estate or trust to claim a charitable income tax deduction may be further complicated by a new proposed regulation that provides that when a governing instrument specifies a source of income (such as IRD) to be used for a charitable income tax deduction, *the instructions must have an economic effect independent of income tax consequences in order to be respected.* Prop. Reg. 1.642(c)-3(b)(2), REG-101258-08, 2008-28 I.R.B. 111. However, the sanction for failure to have an independent economic effect isn't necessarily the loss of a charitable income tax deduction, but rather, a default that the estate's or trust's income will instead be allocated between charitable and non-charitable beneficiaries using the same proportionate ratio of all classes of income of the estate or trust. Prop. Reg. Sec. 1.642(c)-3(b)(2).

f. Transfers to a Charitable Remainder Trust -- Lifetime Transfers PLRs 200335017 (May 27, 2003), 200302048 (Oct. 15, 2002), 200215032 (Jan. 10, 2002), 200202078 (Oct.19, 2001), 200038050 (June 26, 2000) and 199919039 (Feb. 16, 1999): An employee received a retirement plan distribution that included "employer stock." He put the stock into a CRT and rolled over everything else to an IRA. His taxable income was only the original purchase price that the plan had paid for the stock, but he was able to claim a charitable income tax deduction based on the much higher value of the stock that included the stock's "net unrealized appreciation." The employee had no income when the CRT received or sold the stock. PLR 200335017.

g. Transfers to a Charitable Remainder Trust -- Transfers at Death PLRs 199901023 (Oct. 8, 1998), 9634019 (May 24, 1996), 9253038 (Oct. 5, 1992) and 9237020 (June 12, 1992): General rules on transfers at death to charitable remainder unitrusts.

PLR 9820021 (February 15, 1998): Husband names as beneficiary of IRA: a QTIP trust that will pay income to his wife for life and then the remainder to a charity. Charity is treated as a beneficiary for lifetime and post-death mandatory distributions (applied the 1987 proposed regulations -- no affect on lifetime distributions under the 2002 final regs).

PLR 199901023 (Oct. 8, 1998) - What happens to the income tax deduction for the federal estate tax that is paid when IRD is contributed to a charitable remainder trust? The IRS concludes that it is 4th tier corpus in the charitable remainder trust and only the net amount of IRD is included in first tier income.

PLR 200052006 (Sept. 25, 2000) - Decedent's sister disclaims interest in CRT so that decedent's IRAs and annuity contracts can be paid directly to charities; estate gets charitable deduction.

h. An IRA Can Lend Money To A Charity At Market Interest Rates. The Charity Can Use the Loan Amount to Purchase Life Insurance. PLR 200741016 (July 12, 2007). The IRS ruled that the loan to the charity at market interest rates was not a "prohibited transaction" under Sec 4975. Had it been a prohibited transaction, the IRA would have lost its favorable tax status. Sec 408(e)(2). Second, whereas Sec. 408(a)(3) prohibits an IRA from investing in life insurance, the IRS concluded that it was permissible for the charity that borrowed the money from the IRA to purchase life insurance. There may be other legal issues that the PLR did not address, such as state law issues of whether the charity has an insurable interest in the IRA owner.

i. Lifetime Distribution from IRA to Acquire a Charitable Gift Annuity An income tax ***disaster!*** PLR 20056024 (Apr. 6, 2005). Taxpayer withdrew money from his IRA to purchase charitable gift annuities. The entire distribution was taxable and there was only a partial offsetting charitable income tax deduction. Taxpayer pleaded for relief to rollover the money into a new IRA (the normal 60 day limit had expired). The IRS rejected the plea.

j. Transfer of IRA at Death to Acquire a Charitable Gift Annuity PLR 200230018 (Apr. 22, 2002). An individual named a charity as the beneficiary of an IRA and left instructions with the charity to use the IRA proceeds to issue a charitable gift annuity. On an estate tax return, the full value of the IRA must be reported but there is a partially offsetting charitable estate tax deduction. The estate recognizes no taxable income on the transfer (but the ruling did not explain the income tax consequences to the beneficiary of the annuity).

k. Disclaimer of Retirement Assets Possible Even After Receiving An Inherited Distribution. Rev. Rul.2005-36, 2005-26 IRB 1368. Normally a person cannot make a valid disclaimer of an inheritance if that person ever received any benefit from the property, such as interest income. However, the IRS will allow a primary beneficiary to disclaim all or part of an inherited retirement account even if he or she received a mandatory distribution from the account in the year of the account owner's death.

l. Income Taxes Withheld on Charitable Bequest of Retirement Account. Decedent had named a charity as the beneficiary of his retirement account. When the bequest was distributed, the administrator withheld nearly $40,000 of income taxes on behalf of the charitable beneficiary, which was erroneous since the charity was tax-exempt. The charity, however, failed to file a tax return (Form 990-T for UBIT) to claim the withheld amount until more than three years had passed – after the statue of limitations had expired. A U.S. District Court held that the charity would not be able to bring suit to recover the withheld taxes from the federal government. *Family Leadership Foundation v. United States,* (D.C. - Arizona) No. 06 CV-678, Nov. 3, 2006.

2. CHARITABLE BEQUESTS OF EMPLOYEE STOCK OPTIONS AND NONQUALIFIED RETIREMENT PLANS PLRs 200002011 (Sept. 30, 1999) and 200012076 (Dec. 29, 1999) :

A business executive can make a bequest of his compensatory employee stock options, his nonqualified deferred compensation and his taxable death benefits to a charity and his estate will not recognize any taxable income. The employee stock options (nonqualified stock options rather than Incentive Stock Options) would be transferred by instructions in his will. The charity, rather than the estate, will recognize income when the options are exercised. The nonqualified deferred compensation and the death benefits will be transferred to the charity by designating the charity as the successor beneficiary of those payments.

3. CHARITABLE BEQUESTS OF ANNUITY CONTRACTS

a. Taxable proceeds received by estate but given to charitable beneficiaries qualifies for offsetting charitable income tax deduction (residue of estate to charity)- PLR 200537019 (May 25, 2005)

b. Executor distributes annuities to charity even though payable to a trust or to the estate - Decedent named a charity as the residuary beneficiary of the estate. Because the decedent's will authorized the executor to use any asset for any distribution, the IRS permitted the executor to "assign" the deferred annuity contracts retirement accounts to charity. Neither the estate nor any other beneficiary would have to report any taxable income when the distributions were made to the charities. Instead, the charities would report the income. PLRs 200803008 (Oct. 16, 2007) (nonqualified deferred annuity contract payable to a trust where the residue of the trust was payable to charities); 200452004 (Aug. 10, 2004) (both IRAs and deferred annuity contracts). In PLR 200618023 (Jan 18, 2006) the will did not specifically authorize the executor to make non-pro rata distributions, but the executor asserted that such distributions were permitted under state law and the annuity contracts were assigned to the remainderman charitable beneficiaries. The state was not identified.

c. To private foundations - Although normally a bequest of annuity payments to a private foundation would trigger the 2% p.f. excise tax, the tax does not apply if the basis of the annuity contract is greater than its market value. PLR 200425027 (Feb 27, 2004).

d. Disclaimers - Despite being named as the sole beneficiary of decedent's annuity contracts (there were no contingent beneficiaries), sister disclaims her interest in the annuities and in his estate so that the annuity contracts are paid to charities; estate gets charitable deduction. PLR 200052006 (Sept. 25, 2000)

4. CHARITABLE GIFTS AND BEQUESTS OF SAVINGS BONDS

a. Lifetime Gifts - Accrued Interest Is Taxed To Bond Owner. Any lifetime transfer of savings bonds usually triggers interest income. Reg. Sec. 1.454-1(c)(1); Rev. Rul. 55-278, 1955-1 C.B. 471; Rev. Rul. 87-112, 1987-2 C.B. 207 (transfer pursuant to divorce triggers income). An exception is a transfer to a revocable trust. Rev. Rul. 58-2, 1958-1 C.B. 236. For an illustration of a lifetime *charitable* gift of a savings bond, see PLR 8010082 (December 13, 1979).

b. Bequests of Savings Bonds At Death -

1. No Taxable Income To The Estate. In 1998, the IRS released a private letter ruling that confirms that it is possible to transfer savings bonds to a charity upon the owner's death without having any income tax burden imposed on the estate: PLR 9845026 (August 11, 1998). If the recipient is a private foundation, it will be liable for the 2% excise tax on the interest income. Sec. 4940; Rev. Rul. 80-118, 1980-1 C.B. 254.

2. If Income To Estate, How To Claim Charitable Deduction (if residue of estate is paid to charities): PLRs 200826028 (Mar. 27, 2008), PLR 200526010 (March 22, 2005) and 200336020 (June 3, 2003).

3. Distribution of savings bonds to satisfy a pecuniary charitable bequest triggers income taxation to the estate. PLR 9507008 (Nov. 10, 1994).

5. INCOME TAX DEDUCTIONS FOR CHARITABLE BEQUESTS:

a. General Rule: Neither A Charitable Income Tax Deduction Nor A DNI Deduction for an Estate's Charitable Transfer of Principal (e.g., a Typical Charitable Bequest). Rev. Rul. 2003-123, 2003-50 IRB 1200. This is because Sec. 642 imposes a "tracing" requirement for charitable income tax deductions of estates: the source of the contribution must be traced to the estate's income. The requirement is met, for example, when the governing instrument requires the trust's or estate's income to be distributed to charity. It may, therefore, be helpful to have instructions in the trust or will that charitable bequests be made with

IRD.   One rare occasion when the IRS allows charitable income tax deductions in the absence of such an instruction is if a trust or estate holds an interest in a partnership that reports a charitable contribution. Rev. Rul. 2004-5, 2004-3 IRB 295.

b. Satisfying A Pecuniary Bequest With Retirement Assets -- Triggers income to an estate or trust and there is no offsetting charitable income tax deduction unless there are instructions in the document to leave income to charity. The IRS Chief Counsel memorandum. ILM 200644020 (Dec. 15, 2005). See PLR 9507008 (Nov. 10, 1994) (above) for a comparable rule for savings bonds.

c. Taxable proceeds received by estate but given to charitable beneficiaries qualifies for offsetting charitable income tax deduction - PLR 200537019 (May 25, 2005)