Please Note:

Issues of *Futures* appear as they were originally published. Information in these publications has not been updated to reflect changes that could affect calculations given in case examples.

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Futures

Winter 2003

A no-nonsense newsletter for estate planners and financial advisors from The Dayton Foundation

When a Charitable Trust Beats a "Stretch IRA"

By Prof. Christopher R. Hoyt, University of Missouri (Kansas City) School of Law, and Legal Counsel to The Greater Kansas City Community Foundation

A fundamental estate planning principle is that after a person's death, distributions from his or her retirement plan account should be deferred to the beneficiaries for as long as possible. The longer that amounts can remain in a tax-sheltered environment, the greater the investment income for the beneficiaries.

Hoyt will give a continuing education seminar in Dayton on February 11.

For example, if a retirement plan distributes $100 to a beneficiary, the beneficiary must pay federal and state income tax (e.g., perhaps $40), leaving only the after-tax amount for the beneficiary to invest ($60). By comparison, if the plan can retain the amount, the entire $100 can be invested by the plan and the beneficiary can have nearly double the investment income.

In order to defer distributions over the longest possible time period, estate planners generally focus all of their attention on the minimum distribution regulations for retirement plans that were issued in April 2002. Their usual objective is to establish a "stretch IRA" upon the account owner's death. If certain conditions are met, payments from a decedent's IRA may be stretched over the life expectancy of the beneficiary – potentially a very long time!

CHRISTOPHER R. HOYT

Although the final regulations make it much easier to have a stretch IRA compared to the old rules, there still are some situations where estate planners are frustrated. A significant challenge exists when there is a sequence of beneficiaries (e.g., "to A for life, then to B for life"). This situation appears most often with a surviving spouse (e.g., "payments to spouse for life, remainder to children"). If there are multiple beneficiaries, the stretch IRA regulations require distributions to be made over the life expectancy of the *oldest* beneficiary (e.g., the surviving spouse). The IRA will likely be depleted when the oldest beneficiary dies. How can an IRA make distributions over the lives of the younger beneficiaries?

Case Study

Mr. Husband has a terminal illness. He would like his IRA to provide income to his second wife (age 70) for the rest of her life and then provide income to his children from his first marriage (currently ages 42 and 45) for the rest of their lives.

If his IRA is payable to a QTIP trust that benefits both his spouse and children, the IRA must be completely distributed by the year his wife attains age 87 (the life expectancy of a 70-year-old is 17 years). Reg. Sec. 1.401(a)(9)-5, Q&A 7(a) and 7(c)(3), Ex. (1) and Reg. Sec. 1.401(a)(9)-9, Table A-1. The result? The IRA will likely be empty when the surviving spouse dies, leaving nothing in the IRA for the children. What's worse, the IRA must be empty when the surviving spouse attains age 87, even if the spouse in fact lives to be 100!

By comparison, if the IRA is distributed to a CRUT upon his death, the CRUT will provide income to his wife for the rest of her life (which could be well beyond age 87) and then provide income to his children for the rest of their lives. In other words, the CRUT can extend payouts from the *life expectancy* of a 70-year-old to the *actual years* lived by a 42-year-old or a 45-year-old.

The CRUT also provides estate tax advantages: none of the assets in the CRUT will be included on the estate tax return of the surviving spouse. Furthermore, Mr. Husband has the personal satisfaction of benefiting his favorite charity.

The CRUT Solution

A solution to this challenge comes from a completely different field of law than the stretch IRA regulations: a *charitable remainder unitrust* ("CRUT").

A CRUT can benefit a series of individuals for life and then distribute the assets to a charity when the last beneficiary dies. Like an IRA, a CRUT pays no income tax. Unlike an IRA, the term of a CRUT can last until the last of the multiple beneficiaries dies, which will usually be the *youngest* beneficiary. Consequently, a CRUT will usually defer distributions from a decedent's

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When a Charitable Trust Beats a "Stretch IRA"

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IRA longer than a stretch IRA can anytime that there is a sequence of beneficiaries. The benefits will usually be greatest if there is a significant age difference among the beneficiaries or if one of the beneficiaries is elderly. Under the right set of facts, the family will be better off. In addition, a charity will benefit.

For more information on how a charitable remainder unitrust might provide greater benefits than a stretch IRA, please see the May 2002 issue of *Trusts and Estates* magazine and the March 2002 issue of *Planned Giving Today*, (at http://pgtoday.com/PGT/Articles/selected_articles.htm).

You also may contact Joe Baldasare at The Dayton Foundation. ❧

"A CRUT can benefit a series of individuals for life and then distribute the assets [from a decedent's IRA] to a charity when the last beneficiary dies."
– Christopher Hoyt

Note: Solutions differ from case to case. The above does not constitute professional financial or tax advice.

Christopher Hoyt is a Professor of Law at the University of Missouri (Kansas City) School of Law, where he teaches courses in the area of federal income taxation and business organizations. He also serves as legal counsel to The Greater Kansas City Community Foundation. He will be in Dayton on February 11 for a planned giving seminar. See related story.

Hoyt To Present Planned Giving Seminar in Dayton

The Dayton Foundation and The Planned Giving Council of Greater Dayton are pleased to sponsor an educational seminar on February 11, from 8 a.m. to noon at the Dayton Racquet Club, featuring Christopher R. Hoyt, Professor of Law, University of Missouri (Kansas City) School of Law, and Legal Counsel to The Greater Kansas City Community Foundation.

Entitled "Charitable Gifts Including Retirement Plan Assets," the seminar will carry continuing education credits. The Foundation has either applied for or already received credit confirmations for the seminar for three hours of CFPs, CLEs, CPEs, CTFAs, as well as three credits for insurance professionals. There is no charge for the seminar, but space is limited and reservations will be accepted on a first come, first served basis. You may call Deb Seger at The Dayton Foundation at 225-9964 for more information or fill out the enclosed seminar fax form.

Hoyt plans an update on recent tax legislation, including charitable tax provisions, and the impact of the 2002 *final* IRA distribution regulations. Included in "Charitable Gifts Including Retirement Plan Assets" will be the following.

- Tax Planning for Retirement Plan Distributions Under the New Rules Issued in 2002
- Implications of Proposed 2003 Tax Legislation
- Estate Planning for "Income in Respect of Decedent" Assets
- How to Structure Charitable Bequests from Retirement Plan Accounts, Including Transfers to Tax-Exempt Charitable Remainder Trusts
- Situations When a Tax-Exempt Charitable Trust is the Best Solution for an Estate Overloaded with Retirement Plan Accounts (typically a "credit shelter" or QTIP situation funded with retirement assets)
- How to Transfer Employee Stock Options and U.S. Savings Bonds to Charities and Charitable Remainder Trusts for Family Members Without Triggering Taxable Income

Prior to Hoyt's current positions, he was with the law firm of Spencer, Fane, Britt & Browne in Kansas City, Missouri. He has an economics degree from Northwestern University and holds dual law and accounting degrees from the University of Wisconsin.

Hoyt is the author of *The Legal Compendium for Community Foundations*, the most widely used legal reference for community foundations. He is currently the Chair of the American Bar Association's Committee on Lifetime and Testamentary Charitable Gift Planning (Section of Probate and Trust) and serves on the editorial boards of *Trusts and Estates* magazine and the Planned Giving Design Center. He is a frequent speaker at legal and educational programs and has been quoted in numerous publications, including *The Wall Street Journal*, *Forbes*, *MONEY Magazine* and *The Washington Post*. ❧

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