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Board of Regents

April 28, 2017

“FOUNDATION FOCUS”

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Charitable / Estate Planning for Individual Retirement Arrangements (IRAs)

April 28, 2017

Dan Langemo, CFSC
Development Officer
MSU Devotional Foundation

IRA Continuum

59 ½

70 ½

Penalty Period	Optional Period	Mandatory Period
▪ 10% pre-mature distribution penalty tax ▪ Limited exceptions		▪ RMDs ▪ Excess accumulation penalty tax

Uniform Lifetime Table

Required Minimum Distributions

Age of Retiree	Distribution Period (in years)	Age of Retiree	Distribution Period (in years)
70	27.4	82	17.1
71	26.5	83	16.3
72	25.6	84	15.5
73	24.7	85	14.8
74	23.8	86	14.1
75	22.9	87	13.4
76	22.0	88	12.7
77	21.2	89	12.0
78	20.3	90	11.4
79	19.5	91	10.8
80	18.7	92	10.2
81	17.9	93	9.6

Uniform Lifetime Table

Required Minimum Distributions

Age of Retiree	Distribution Period (in years)	Age of Retiree	Distribution Period (in years)
94	9.1	106	4.2
95	8.6	107	3.9
96	8.1	108	3.7
97	7.6	109	3.4
98	7.1	110	3.1
99	6.7	111	2.9
100	6.3	112	2.6
101	5.9	113	2.4
102	5.5	114	2.1
103	5.2	115 (or older)	1.9
104	4.9		
105	4.5		

Example of Required Minimum Distributions

Assumptions:

IRA beginning account balance @ age 70 ½ :	$150,00.00
Annual investment return:	4.50%
RMD payment date:	last day of calendar year

	Year 1	Year 2	Year 3
Beginning Balance	$150,000	$151,276	$152,374
Earnings	$6,750	$6,807	$6,857
Adjusted Total	$156,750	$158,083	$159,231
Less RMD	$5,474 (27.4)	$5,709 (26.5)	$5,952 (25.6)
Ending Balance	**$151,276**	**$152,374**	**$153,279**

90-90-90 Rule – A. Charles Schultz, Esq.

Point: Account holders who live to their late 80s or into their 90s are likely to die with their IRAs largely intact.

IRA Conundrum

While IRAs are excellent accumulation vehicles, they make for lousy inheritance assets

- Represent a "tax due" bill to Uncle Sam
- Very inefficient assets from a tax & estate planning standpoint. Why?
  - No step available at death in tax cost basis
- Stocks, bonds, mutual funds, real estate –
  - All receive a step-up in basis upon death
- These are tax <u>efficient</u> assets, as they can be subsequently sold or liquidated, often with little - if any – tax consequences (from a capital gains standpoint).

Planning Consideration

From an asset disposition standpoint, it would seem to make more sense to leave tax efficient assets to loved ones / family members, and the tax inefficient assets (i.e. IRA) to the charitable organization.

Reason

Charities are tax-exempt, and therefore completely avoid any income tax liability.

Anecdotal experience

Most tend to do exactly the opposite:

They leave the tax efficient assets in the form of specific gifts or bequests to the charitable organizations

And

They tend to leave the tax inefficient assets (IRA) to the surviving spouse or family members (via beneficiary designation).

Example

"I hereby bequeath the sum of $100,000 to the Minot State University Development Foundation.

NOTE: That same amount – if held in an IRA – would pass outside of the will to spouse / family members.

Estate of Joe Donor

Assets	
Home / personal residence	$300,000
Checking / savings / CD accounts	$250,000
Investments / marketable securities	$200,000
IRA	$100,000
Automobile(s)	$50,000
Personal property / personal effects	$25,000
Total Assets	**$925,000**

Liabilities	
None	$0

Net worth	
	$925,000

Estate of Joe Donor

Asset Ownership	
Residence (JTWROS)	$300,000
Checking / Savings / CDs (JTWROS)	$250,000
Investment Accounts (Decedent)*	$200,000
IRA (Beneficiary : Spouse)	$100,000
Automobile(s) (JTWROS)	$50,000
Personal Property (Decedent) *	$25,000
Total Gross Estate	**$925,000**
Less: Non-Probate Assets	($700,000)
Net Value of Probate Estate	
	$225,000

* Probate Assets

JTWROS = Joints Tenants with Rights of Survivorship

Scenario 1

Will provides for $100,000 bequest to MSU Development Foundation

Outcome	Family/Spouse	Charity	Total
Asset disposition / gifts	$825,000	$100,000	$925,000
Less: Income Tax Liability (28% Fed. Only)	($28,000)	$0	($28,000)
Net Amount	**$797,000**	**$100,000**	**$897,000**

Scenario 2

Same exact situation as Scenario #1, except IRA left directly to charity (no testamentary bequest)

Outcome	Family/Spouse	Charity	Total
Asset disposition / gifts	$825,000	$100,000	$925,000
Less: Income Tax Liability (28% Fed. Only)	$0	$0	$0
Net Amount	**$825,000**	**$100,000**	**$925,000**

IRA Charitable Rollovers

- Made permanent in late 2015
- Available to IRA owners Age 70 ½ (or older)
- Provides for tax-free transfers from IRAs to qualified charitable organizations (MSU Foundation)
- No income tax charitable deduction, but complete avoidance of income tax liability
- Reduction of donor's taxable estate for federal estate tax purposes.
- Can satisfy some or all of a donor's annual Required Minimum Distribution (RMD)
- Can facilitate larger lifetime gifts to charity, as opposed to an end-of-life gift pursuant to an IRA beneficiary designation. Example: Scholarship Endowment

Stretch IRAs

- A/K/A "Extended IRAs" "Legacy IRA" "Multigenerational IRA"
- Stretch IRAs are basically traditional IRAs turned into a long-term family wealth management vehicle.

Concept / Goal:

The longer you can keep the taxman waiting to collect his money, the more time it has to grow for you and your family, and build a fortune.

How is "stretch IRA" accomplished?

- Name a person as beneficiary on IRA beneficiary form (as opposed to the estate).
- The person then spreads required distributions for the account over his/her remaining life expectancy.

Note:

- The younger the person named, the longer his/her life expectancy, thus the greater the financial value of the stretch options.
- May take decades before all of the money is forced out through distribution.

Stretch IRAs on the "endangered species" list

- Senate Finance Committee voted 26-0 back in September to kill the "stretch IRA" for non-spousal beneficiaries.

Note: In the past – whenever you had a 26-0 senate vote – the legislation always became law the next year)

Retirement Improvement & Savings Enhancement (RISE) Act

- Significantly curtail the ability to "stretch" distributions from inherited IRAs by requiring the entire account balance be distributed within five years of the accountholder's death.

Exceptions:

1. Account holder's surviving spouse
2. A minor
3. An individual with special needs, or
4. A designated beneficiary within 10 years of the age of the accountholder.

Note: Proposed legislation includes a $450,000 exemption, applicable to non-spouse beneficiaries. Amounts in excess subject to the quicker payout.

Stretch IRAs

Stretch IRA legislation

- Chances of passage: Good to very Good (No "save the stretch" lobby)

Reason:

- Accelerated tax revenues. Estimated impact of $3 billion - $5 billion in additional tax revenues over next decade.

Bottom line:

- New rule would dramatically speed up the pace of withdrawals, forcing many beneficiaries into higher income tax brackets.

Conclusion:

- Charitable IRA option will become even more attractive for many IRA account holders.

Three IRA beneficiary mistakes you must avoid:

1) Naming your **estate** as primary beneficiary:

   A. Turns your retirement plan into PROBATE asset:

      1. Probate Costs.
      2. Creditors' Claims.

   B. No ability for a "Stretch IRA" opportunity. Why? Estate is not considered a "Designated Beneficiary" and if there is no designated beneficiary, there is no life expectancy, which means stretch IRA opportunity is lost.

   Note: Estate as primary beneficiary is generally the default option.

2) Failure to update Beneficiary Designation form(s).

   Note: Beneficiary Designation form trumps all other documents, including a will.

   Example: Ex-spouse named as primary beneficiary

3) Naming charity as beneficiary of a Roth IRA.

   Reminder: Contributions to Roth IRA are made with after-tax dollars. Leaving Roth assets to a charity that pays no taxes, simply means that you paid unnecessary taxes.

   Regular/ Traditional IRA to charity: Fine.

   Roth IRA to Charity: not a good solution.