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Using a CRT or CGA to Stretch Payments From a Retirement Plan

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The SECURE Act that was signed into law at the end of 2019 contained several provisions that drew the attention of gift planners. One provision of the Act was elimination of the so-called "stretch" IRA for most non-spouses.

Limits on the availability of the stretch IRA
Before the SECURE Act, the new owner of an inherited IRA could "stretch out" required minimum distributions (RMDs) over their life expectancy. This was a tax-advantageous thing to do, for the IRA could continue to generate income and realized capital gain free of tax as long as the assets remained in the IRA. IRA assets are taxed to the beneficiary only when withdrawn. It was common estate planning practice for IRA owners to designate children, or even grandchildren, as IRA beneficiaries who could stretch out RMDs for decades while enjoying tax-free growth.

The SECURE Act significantly limited who can stretch payments from an inherited IRA over their life expectancy. Now, only the following people can stretch distributions from an inherited IRA over their life expectancy:

- a spouse
- a non-spouse who is less than 10 years younger than the deceased owner
- a minor child of the deceased owner
- someone who is chronically ill or disabled

Any other inheritor of an IRA, such as an adult child, must withdraw all assets in the IRA within ten years of the death of the IRA owner and pay income tax on the withdrawals. The owner can take distributions any way she wants as long as she withdraws all funds within the ten years. There are no RMDs. Beneficiaries of IRAs inherited prior to 2020 are grandfathered in under the old rules; they can continue to take distributions over their life expectancies.

SECURE Act limitations on stretch IRA excited gift planners

IRS statistics indicate traditional IRAs held nearly $8 *trillion* in assets at the end of 2018, the latest year for which data is available. That is a huge potential source of charitable gifts. Any change that might increase the likelihood of gifts of IRA assets is enough to get gift planners excited, and rightly so.

Gift planners recognized that for charitably minded IRA owners, the elimination of the "stretch" IRA created an additional incentive to designate what is left in their IRA to one or more charities and use other funds to benefit their heirs. Doing so avoids income tax on IRA funds that would otherwise all be taxed within ten years of the IRA owner's death and provides heirs with other funds that would not be taxed.

The key is that the IRA owner must want to make a gift to charity. If the IRA owner's goal is to pass as much as possible to heirs, then she should bequeath her entire estate to her heirs. On the other hand, if she wants to make a gift to charity through her estate, using her IRA assets to do so is the tax-efficient way to go.

Example: Suppose Dr. Smith has planned on leaving $1 million to her favorite charity. Yours! Her estate is worth $5 million at her death, including an IRA with assets worth $1 million. Her estate is well under the current estate tax exemption of $11.7 million, so it will not owe any federal estate tax. Nevertheless, giving her IRA assets to your charity and other assets to her heirs will save a lot of tax. Income tax.

If she gives her IRA assets to charity and the rest of her estate to her children, there will be no tax on either transfer. In addition, the children will receive a step-up in basis on their assets: when they sell any of them, they will owe capital gains tax only on appreciation accumulated after they became the owners of the assets.

If Dr. Smith does the opposite and gives her IRA assets to her children and $1 million in stock to your charity, her children will have to pay income tax on the IRA assets. This tax could be as much as $370,000 if her children are in the highest federal tax bracket. Even if they roll over the assets into an inherited IRA, they will have to pay income tax on all the IRA assets within ten years.

A Life Income Plan as a Substitute for a Stretch IRA?

Some gift planners have suggested that donors may be interested in transferring their IRA assets to a testamentary charitable remainder trust (CRT) or gift annuity as an alternative to the old stretch IRA. As with the old stretch IRA, the IRA assets would not be exposed to income tax when transferred,* the donor's children could receive income from the charitable plan for life, and the assets in the CRT or gift annuity would not be taxed until distributed to the children.

There is an important difference, however. The beneficiaries will have no control over how much they can receive from the plan each year. With a gift annuity, they will receive a fixed amount each year. With a CRT, they will receive either a fixed amount or a fixed percentage of the assets in the trust, depending on the type of CRT. That means, unlike with an inherited IRA, the beneficiaries have no access to the principal should they want or need it.

Funding a testamentary gift annuity or CRT with IRA assets is less an alternative to the stretch IRA than it is a compromise between giving the IRA assets outright to charity and giving them outright to children or other heirs. Put another way, a donor who, prior to the SECURE Act changes, would have bequeathed her IRA to children rather than use its assets to fund a gift annuity or CRT is very likely to make the same decision after the SECURE Act changes.

(*The IRS has issued several private letter rulings supporting this position. While a PLR can be relied upon only by the taxpayer that requests the ruling, the PLRs do indicate how the IRS is likely to rule on the issues covered in the ruling.)

Funding a Charitable Remainder Unitrust with IRA Assets

Among the charitable life income plan options, funding a charitable remainder unitrust (CRUT) is likely to be the most appealing option for a donor who is considering funding a testamentary life income plan with IRA assets for the benefit of children. For one, there is the possibility of increasing payment amounts to the children over the several additional decades they are likely to live. Also, the estate tax charitable deduction available for funding a CRUT likely will be more than for funding a gift annuity or charitable remainder annuity trust. This will mean a greater benefit for the donor's estate if the estate is large enough to owe estate tax. Lastly, a CRUT needs to meet minimum funding requirements to justify the cost of drafting the legal document and administering the trust during its term. A funding amount of at least $100,000 is about the bare minimum that is viable. More is better. So, a donor's IRA needs to have a substantial balance when it ends for funding a CRUT to make sense. If there is doubt that a sufficient IRA balance will be available to fund a CRUT, the donor could consider funding a gift annuity instead. The minimum gift amount for a gift annuity is just $10,000 at most charities.

Example: Suppose you learn that Dr. Smith has two children whom she would like to provide with an income stream after she is gone. Rather than leave the $1 million in her IRA to your charity outright, she could fund a 5% CRUT, instead. You estimate her children will be 62 and 60 when she passes away, and the children will live for another 28 years (their joint life expectancy). If we assume the IRS discount remains the same and the CRUT averages 3% income and 5% appreciation each year over its term, the benefits would be as follows:

Estate tax deduction	$282,840
Income tax saved (@ 37% rate)	$370,000
After-tax benefit to children	$1,270,755
Remainder to your charity	$2,287,928

Many assumptions underlie these numbers. We do not actually know how old Dr. Smith's children will be when the CRUT is funded, or what the investment performance of the CRUT will be during its term, never mind what the estate tax rules will be in the year Dr. Smith dies. These projected numbers are educated guesses. They are useful for explaining the concept of funding a testamentary CRUT with IRA assets. The one thing we know with certainty is that the actual results will not match these numbers. They may be similar, substantially smaller, or substantially larger, but they will not match.

Summary

For donors with IRAs (or other qualified retirement plans) who wish to leave a bequest to your charity, it is a no-brainer for them to use these funds to accomplish their gift and bequeath other kinds of assets to heirs. They will avoid burdening their heirs with income tax unnecessarily. For donors with large retirement plans who wish to provide lifetime income to heirs and make a generous gift to charity, designating a testamentary charitable remainder unitrust as the beneficiary can be an attractive solution. Predictions that SECURE Act restrictions on the availability of the stretch IRA would create a surge in testamentary CRTs and gift annuities as stretch IRA alternatives seem overblown. The same donors who would have bequeathed their IRAs to children prior to the SECURE Act are very likely to make the same decision today.