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Tools and Tripwires Involved in Using Retirement Accounts for Charitable Planned Gifts

By Kal Grant and Greta E Cowart[*]

Near the end of any year, mailboxes are stuffed with requests from charities. For many individuals, the desire to respond to the requests outweighs their ability to give. For these individuals, planned gifts can be an easy and effective way to earmark future funds for a charity or charities without a current expenditure. Even in the rush of the holidays, however, individuals should consider all of the planned giving tools available to them as well as the tripwires that may catch the unwary.

A planned gift is generally defined as a gift an individual creates during her lifetime that will take effect at or after her passing. There are many kinds of planned gifts. The most common planned gift is a bequest in a will or a direction in a trust to make a gift to charity at a later date. More complicated gifts include charitable remainder trusts and charitable lead trusts that ''split'' their assets between individuals and one or more charities. Some planned gifts are made through beneficiary designations for a financial asset that is payable upon the donor's death, such as a life insurance policy or an IRA.

Using a retirement account for a planned gift can be a very effective and a very convenient solution for an individual who wishes to be a recognized donor of a charity but who cannot commit to a current large gift. Effective for tax purposes, because retirement plan assets at death are subject to both estate and income taxes, which means a substantial portion of such assets will likely go to the Internal Revenue Service. Making a charity the beneficiary of an IRA or other retirement account leaves the full value to be used by the charity. It is also convenient because almost every mid-size and large employer has a retirement plan, and many individuals have IRAs and small, mid-size, and large balances in plans with more than one former employer. Would-be donors therefore often have a number of accounts from which they can make gifts. When using a retirement plan, as opposed to an individual retirement account, the retirement plan's rules for beneficiary designations must be considered, for example, the rights of the surviving spouse and other restrictions the plan administrator may impose.

The steps for using a retirement account for a planned gift can be as simple as updating a beneficiary designation form through the plan administrator. In the past, an account holder typically had to choose a beneficiary for an IRA or retirement plan by the required beginning date for lifetime RMDs. The choice was then ''locked in'' (at least for certain purposes) on the earlier of that date or the date of the account holder's death. Fortunately for account holders and for potential beneficiaries, final IRS regulations issued in 2002 extended the deadline for finalizing beneficiary choices for purposes of post-death distributions until September 30 of the year following the account holder's death.[1] In other words, an account holder generally is free to change beneficiaries any time during life. Proposed regulations changing the tables for calculating the minimum required distributions were

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[1] Treas. Reg. §1.401(a)(9)-4. All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), and the regulations promulgated thereunder, unless otherwise indicated.

published in the Federal Register on November 8, 2019, with a proposed effective/applicability date for distributions beginning in calendar years after January 1, 2021, but also include transition rules with respect to individuals passing prior to such date that will need to be watched.[2] These proposed rules extend the life expectancy tables, and this may indicate accumulations in retirement accounts will be paid out more slowly when these are effective and impact the accumulations available for charitable gifts in future years.

However, as the saying goes, the devil is in the details. When making planned gifts with retirement accounts, many of the tripwires are in the details of the beneficiary designation form. One of the most common tripwires in designating a charity as a retirement account beneficiary is getting the charity's name wrong (not just misspelling the charity name, which happens not infrequently, but actually naming the incorrect entity). Many organizations have very similar names, particularly religious organizations. Discovering the ambiguity after the account holder's death can mean significant delays and even judicial proceedings before any beneficiaries receive funds. In addition, charities sometimes have separately established supporting organizations or other related entities set up to receive and protect any planned gifts. To ensure that the planned gift is recognized and is headed to the right place when the time comes, individuals should check with their intended charity ahead of signing the new designation form for a retirement account.

Another tripwire involves failing to correctly designate the amount or percentage of the account to go to the charity. Many account holders don't realize that they can ''split'' a retirement account between beneficiaries. Or, they may realize that they can split it between their children, but they don't realize they can split it between family and charities. Once the would-be donor sets a course to split their retirement account between charitable and individual beneficiaries, there is a real risk of over- or under-funding the charitable gift. Depending on the age and health of an individual signing the beneficiary designation form, the value of a retirement account may increase (or decrease) substantially before death. As a result, a gift of a specific percentage of the account may yield a vastly different gift amount than was intended. Similarly, a gift of a specific dollar amount may fail to take into consideration the inflation that may occur prior to death. To avoid the risk of over- or under-funding before submitting a new beneficiary designation form, a would-be donor should give sufficient consideration to the current value of the account and its asset allocation, and to the impact that time may have on the intended gift. Every individual should also plan to periodically review all the beneficiary designations. Another tripwire is making the beneficiary designation for the charity in a complex formula or in a manner a qualified retirement plan's plan administrator will not accept or administer.

Many charitable organizations have created planned giving programs that include a ''legacy society.'' These societies often offer added benefits to legacy society members, such as invitations to private events and public recognition. The tripwire for individuals wishing to use their retirement accounts to gain membership in a legacy society involves failing to determine the minimum planned gift that will qualify for membership. The minimum varies widely from one organization to another and often depends on the age of both the organization and its planned giving program. Similarly, the documentation that will be required to prove the gift is very specific to each organization. Some charities will accept a one-page form that simply states the amount that is expected to accrue to the charity. Other charities will want a copy of the beneficiary designation form and/or a copy of a statement showing that funds are reasonably expected to be sufficient to fulfill the gift. Individuals should check with the intended recipient charity to confirm their gift will be accepted and that they are comfortable with the level of information that will have to be disclosed.

Tripwires may also be crossed when the planned gift will be made from an IRA holding ''nontraditional'' assets. In an investment world that has become increasingly complicated, many IRAs are holding assets other than the old-school stocks and bonds. These IRAs may be holding, for example, precious metals, real estate, and even closely-held business interests. Individuals holding these kinds of assets in their IRAs are usually aware that the Internal Revenue Code and ERISA put strict controls on those types of investments in IRAs while the account holder is alive, and some investments may be considered prohibited transactions, or generate unrelated business income tax.[3] However, these same individuals are often unaware that their chosen charity may not want the assets in the IRA after the account holder's death. Charitable organizations have learned to be much more circumspect about the assets they accept, particularly real estate. Moreover, charities generally are also subject to stringent restrictions regarding nontraditional holdings. To avoid this tripwire, individuals should have a frank discussion with their chosen charity before naming that charity as a beneficiary of an IRA with a complex asset.

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[2] REG-132210-19, 84 Fed. Reg. 60,812 (Nov. 8, 2019).

[3] ERISA §406, ERISA §408, Code §512, Code §4975.

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The last, but certainly not least, of the tripwires is a failure by the account holder to inform her family that a charity has been named as a beneficiary. There are legal reasons an individual should discuss her intent with her family: if an account holder is married, federal law requires, for some employer-sponsored retirement plans, that the surviving spouse sign a written waiver if he will not be the primary beneficiary.[4] A non-owner spouse in a community property state also may have legal rights in a retirement account regardless of whether he is named as the primary beneficiary. Moreover, if the non-owner spouse dies first in a community property state, that state's law may prevent the surviving owner spouse from changing the beneficiary designation after death. There are personal reasons for a discussion with family as well: finding out that some or all of the account assets are being distributed to a charity can result in a very disappointed and litigious heir. To ensure the charity or charities and the family members receive what they expect, individuals should discuss their entire estate plan with their families, including any and all beneficiary designations.

For charitably minded individuals with retirement accounts, a planned gift can be an effective and convenient way to support their favorite cause. Would-be donors should take the time, however, to consider all of the planned giving tools available to them as well as the tripwires that may undermine the gift. Consulting with the charity (or charities) about retirement plan assets, asking the plan administrator regarding restrictions on beneficiary designations it will administer, and discussing the gift with family members before signing a new beneficiary designation form should even the road to ensuring all of the beneficiaries receive what they expected.

[4] Code §401(a)(11), Code §417.

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