Charitable Remainder Trusts — An Estate Preservation Tool with the SECURE Act

by James Lange, Retirement Daily Guest Contributor

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With some exceptions, an inherited IRA or retirement plan will have to be distributed and taxes within 10 years of the original owner's death. One strategy to offset the forced income-tax acceleration is to set up a Charitable Remainder Trust (CRT) as the contingent beneficiary of your IRA or retirement plan—your spouse would be the primary beneficiary.

Why Consider a Charitable Remainder Trust?

Conventionally, you would leave your IRA directly to your child to be distributed and taxed within 10 years. But with the new Required Minimum Distribution (RMD) rules in the SECURE Act, even if charitable giving is not your top priority, your child could potentially receive more money and a steadier income if you name a CRT as the beneficiary of your IRA instead of your child directly.

Bottom line: If you have a million dollars or more in your IRA, you should at least consider naming a CRT as the beneficiary of your IRA.

What is a CRT?

Here are the basics on Charitable Remainder Trusts. When you die or when both you and your spouse are dead, what remains of your IRA is transferred to a CRT and the Inherited IRA is then liquidated without paying taxes. A CRT is a testamentary trust; it isn't funded before you and your spouse die. It is totally revocable meaning you can change it as long as you and/or your spouse are alive. While you are alive no money goes into it. Other than some paper sitting in a secure place, it doesn't exist. But, after you and your spouse die, if it is named as the beneficiary of your IRA or retirement plan, it comes to life.

The CRT must be set up so that that the charity receives at least 10% of the present value of the bequest at the date of death; but that leaves 90% for your child. When you figure in the enormous tax benefits of the CRT, your child often gets more value, sometimes by hundreds of thousands of dollars, than if you just leave the IRA outright to your child.

With a CRT, your child won't get a lump sum of money—but he or she also will not face a big tax bill immediately after you die or as big a tax bill even 10 years after you die. What your child will get is a regular "income" from the CRT for the rest of their life. (The distribution is usually between 5% or 10% of the assets depending on the age of the beneficiary and the Section 7520 rate under the Internal Revenue Code.)

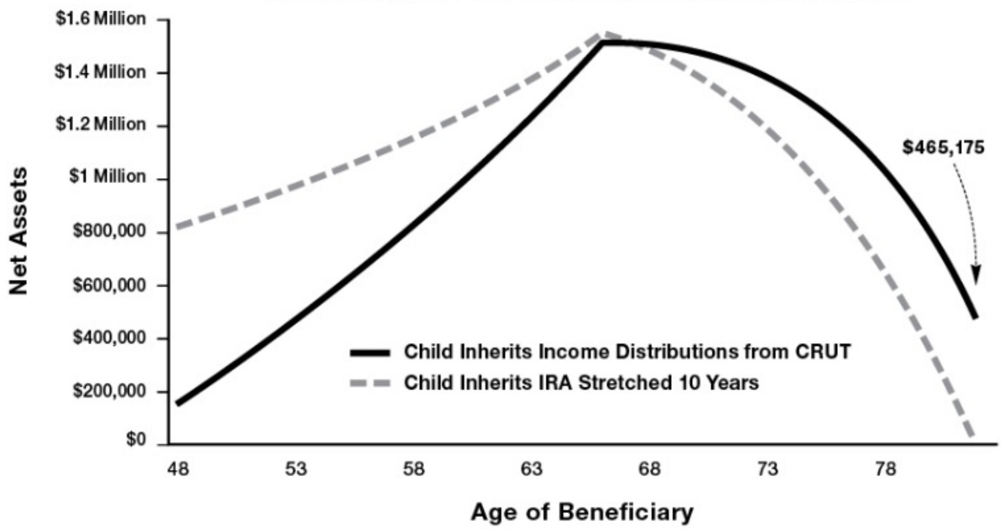
Distributions from the CRT are treated as ordinary income until the amount of the initial IRA plus any interest and dividends earned in the CRT have been paid to your child. After the ordinary income has been distributed, then capital gains would be distributed from the CRT and that distribution would be taxed at the more favorable capital gains tax rates. Finally, when your child dies, whatever is left in the CRT goes to the charity of your (or your child's) choice.

Is a CRT The Right Choice for You? Maybe.

The graph below shows that your child will likely get more money over his lifetime as the beneficiary of a CRT than if he receives your $1 million IRA outright.

GRAPH 8.1

Income from a Trust *vs.* IRA Stretched 10 Years



Graph Assumptions

- 80-year-old parent dies with $1,000,000 IRA & $100,000 cash
- 7% rate of return

- 3.5% inflation on income and expenses
- Child 48 when parent dies
- Annual distributions from Inherited IRA $143,000 for 10 years (32% tax bracket)
- Total income distributed from IRA, $1,421,399
- Total income distributed from CRT, $1,946,227
- Child's wages $100,000 to age 65
- Child's Social Security at FRA, $27,000
- Child's annual living expenses $90,000

Having charity in your heart is a major bonus, but given the right facts, it might be a great solution—or a partial solution—even if you are much more focused on your family than charity. It is possible, even likely, that your child would actually end up with more money if you left the IRA to a charitable trust than if you left it to him or her outright.

James Lange, a CPA, Attorney and Registered Investment Advisor, is a nationally-recognized IRA, 401(k), and retirement plan distribution expert. Lange is the author of several best-selling books that help IRA and retirement plan owners to get the most from their retirement plans using Roth IRA conversions and tax-smart planning as an integral part of the planning strategy. For more information, visit www.PayTaxesLater.com.