

# Leaving More Lifetime Income to Your Family From Your IRA

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## The Role of Charitable Trusts & the Math Behind the Tax

In January 2020, most provisions of the SECURE Act went into effect. Among them was a provision which eliminated a valuable benefit known as the stretch IRA. The stretch IRA allowed non-spousal beneficiaries to enjoy the advantage of tax-deferred growth by limiting the mandatory tax of an inherited IRA to the Required Minimum Distributions (RMD) each year.

This was replaced by a mandatory payment of all taxes on the inherited IRA no later than the end of the tenth year after the death of the IRA owner. The difference created by the SECURE Act provision can be considerable, especially in terms of what you leave to the people you love.

Although the SECURE Act eliminated the stretch IRA strategy, IRA owners who are updating their estate plans may find a potential substitute for the stretch IRA strategy by using a charitable trust as the beneficiary of their IRA. By using this trust you eliminate the SECURE Act tax, thus providing more lifetime income to your loved ones.

There are three primary reasons for using a charitable trust, especially when your beneficiaries stand to inherit large amounts from your IRA.

1. The only item that changes with your IRA during your lifetime is that the beneficiary is changed from your loved one (non-spousal, designated beneficiary) to the charitable trust. Your loved one becomes the income beneficiary of the trust and you lose absolutely no control over your IRA. You can still change beneficiaries, spend as much of your IRA as you want, change investments, or decide to get rid of the charitable trust if your situation changes.
2. Since the charitable trust is a tax exempt entity, you completely eliminate the SECURE Act tax when you pass away. This is a critical benefit because it will mean more assets in the trust and more lifetime income for your loved ones when compared to paying the SECURE Act tax on your IRA.
3. Since the assets still in the trust are gifted to the charity of your choice when your beneficiary passes away, your estate receives a tax deduction when you pass away. If the federal estate tax exception is lowered to \$3.5 million per individual as proposed, then that deduction through the charitable trust could mean more assets left for your family and less left to the government in the form of estate tax.

To stay balanced in our discussion, it must be noted that there are no assets left for the next generation, as was the case when using the stretch prior to 2020, because the assets of your IRA are left to a charity. However, the SECURE Act really leaves you with only two choices; pay taxes to the IRS or have it left to the charity of your choice when the IRA beneficiary passes away.

It is also important to note, the payout rate to your loved one can be maximized at a rate that will provide the charity on an actuarial basis at least 10% of the value of your IRA when transferred to the charitable trust. This is known as the "10% test."

Said differently, to pass the 10% test the IRS has on these charitable trusts, the trust can be structured so your loved one receives distributions equivalent to up to 90% of your IRA plus the income during their lifetime. It will not be a problem if they live beyond their actuarial age and deplete the entire trust, as long as they pass the 10% test when the assets initially went into the trust.

Again, to be balanced in our discussion, if your beneficiary passes away early in the charitable trust payout, it could be a wind-fall for the charity.

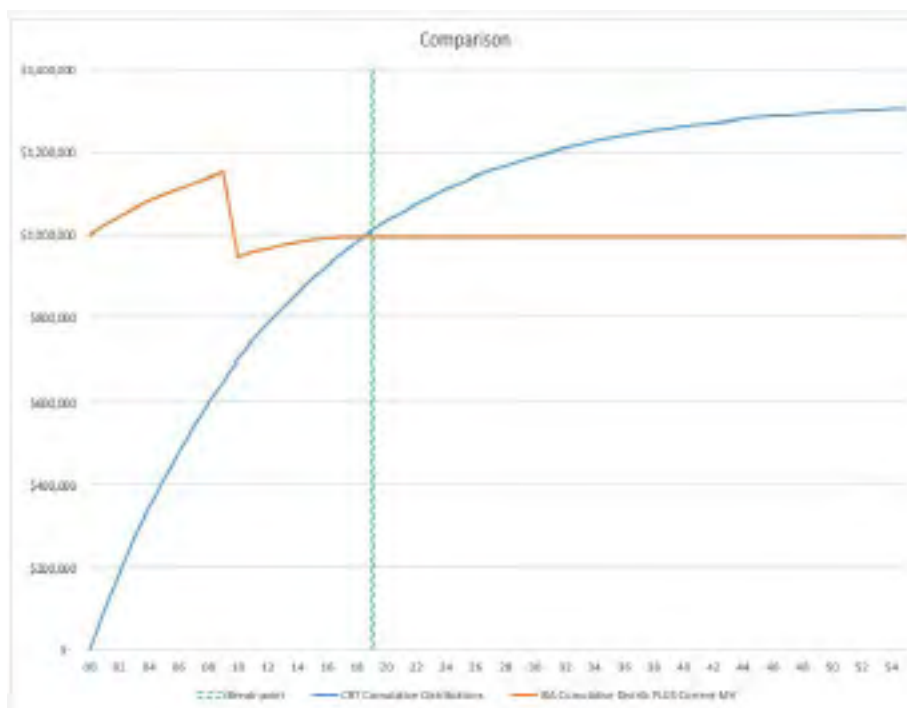
If you are concerned about leaving something to the next generation beyond the beneficiary of the charitable trust, there are strategies that can be used to replace the assets left to the charity.

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## Case Study

You establish a charitable trust to be the beneficiary of your IRA and name your loved one as the beneficiary of the trust. When you pass away, the beneficiary is 58 years old and your IRA has a value of \$1 million. Let us use the set of assumptions in footnote (1) and compare leaving the IRA outright to your loved one subject to the SECURE Act tax or using the charitable trust strategy.

If we try to deliver the same after-tax income as the charitable trust compared to paying the SECURE Act tax, as you see from the graph below, the assets when paying the SECURE Act tax are gone and the income stops by the 19th year — which is age 77 in our example (2).



Source: Dunham Trust Company

By age 90, the charitable trust would have paid after tax distributions of \$1,209,593 and there would be \$85,418 of assets remaining for income if the beneficiary continues to live or as the charitable gift if the beneficiary passes away (2).

Using a charitable trust is not the only strategy when planning for your IRA beneficiaries, but most of the other strategies will involve paying taxes at one time or another by either you or your beneficiary. This strategy can give your loved ones more lifetime income, a tax deduction for your estate, and a gift for a charity you are passionate about.

(1) Here we will assume the beneficiary receives an average 6% rate of return, is in a 24% federal tax bracket, and a 4% state income tax bracket. When they pay the SECURE Act tax at the end of the 10th year, since they will have over \$1 million of income from the IRA that year, we will assume a 37% federal tax rate and a 6% state income tax rate.

(2) Source: Dunham Trust Company

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