

Using IRAs with Charitable Remainder Trusts

(Part 2 of 3)

In the first part of this series, we discussed various client planning dynamics that may be on a collision course with each other: personal planning goals, estate tax goals, income tax deferral goals, and the mixed (and often inconsistent) advice of a myriad of professional advisors.

We then introduced a strategy that might keep all of these dynamics in balance and provide a great solution for the appropriate client.

By way of review, the strategy goes like this:

1. Client creates an estate plan calling for the creation of a Charitable Remainder Unitrust on death (thus testamentary CRT)
2. Client names CRT as beneficiary of his or her IRA
3. The CRT receives a lump sum distribution of the IRA assets on client's death
4. The beneficiaries of the CRT receive a set annual percentage payout from the CRT for life
5. Upon the death of the final beneficiary, the "remainder" of the CRT principal is paid to the charity or charities named in the CRT

So what are the benefits of the IRA-to-Charitable Remainder Trust strategy? To fully understand the answer to that question, we need to discuss the basics of Charitable Trust taxation. Here are some of the key principles:

1. When the IRA assets are contributed to the testamentary CRT at the owner's death, the CRT pays NO income tax because of the unlimited charitable deduction
2. The IRA assets ARE included in the owner's estate at the owner's death
3. However, the estate receives a charitable deduction against estate tax for the present value of the charity's remainder interest
4. Assets are invested and grown income-tax free inside the CRT
5. The "Unitrust" amount set by the CRT is paid out annually to the named beneficiaries
6. The income beneficiaries of the CRT DO pay

income tax on the payouts, based on the CRT's four-tiered income tax system (which is calculated to provide the most tax for the IRS):

- a. Ordinary income and short term capital gains
- b. Long term capital gains
- c. Other (municipal bond income; non-taxable)
- d. Return of principal

For example, if the CRT pays out 6% annually, and it earned 6% of ordinary income that year, all would be taxed as ordinary income to beneficiary.

If, on the other hand, the CRT pays out 6% annually, and it earned only 2% of ordinary income that year, the first 2% of the payout would be taxed as ordinary income to the beneficiary, while the other 4% would be taxed at one of the lower tiers.

In the final part of this series, we'll answer the "So What?" question and suggest some planning points for using this strategy to maximum advantage.



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