Taking Distributions When You Don't Need the Money to Live on

Are you up to speed on your options and the rules?

By Randy Fox

Key Takeaways:

- Retirement and estate planning have become increasingly complicated. Some affluent retirees find themselves forced to take required minimum distributions (RMDs) of their IRAs at 70 1/2 even if they don't need the money—thus paying tax on income they don't want.
- It is always better to consider several options in the context of an overall plan before making a decision on a particular strategy.

As many of you know, I do a lot of work with the Planned Giving Design Center (PGDC), whose mission is to develop products and services for the charitable gift and estate planning industry that assist others in their efforts to increase philanthropy.

PGDC's wide reach leads to many interesting opportunities, not the least of which are questions from donors about gift structures, strange opportunities or other inquiries. Most recently we received a call from an inquisitive gentleman from the East Coast. It was one of those "Should I do this?" calls. Essentially, a proposal was on the table from his advisor and he was confused by it. Sound familiar?

Here are the facts as the man explained them to me. He is 68 years old, still working and quite healthy. He is divorced, has two grown children and a significant other. His total assets are around $5 million, but $2 million is in his IRA. His main concern is that when he turns 70 1/2, he will have to begin taking required minimum distributions from his IRA and he doesn't think he'll need the money to live on. Essentially, he would be paying tax on income that he didn't want. Currently, he gifts regularly to the university he attended, but he has been doing that with appreciated securities.

An advisor (I'm not sure if it was a planned giving officer, an attorney or a financial advisor) suggested the following to the caller: Withdraw the entire IRA and place the proceeds in a Charitable Lead Annuity Trust (CLAT). Despite not having all the information, I was able to determine that the CLAT was a grantor CLAT, which means the income tax deduction would flow through to the man's personal return. According to the advice, the man would receive a 90 percent income tax deduction. My later calculations suggested that a 15-year, 7 percent payout trust would accomplish something close to that result. Gathering more information, I determined that this transaction would add about $140,000 to the man's current year income taxes and raise his marginal rate from 28 percent to 39.6 percent.

Pros and cons of grantor CLATs

How does this transaction benefit our East Coast friend? Certainly, he does get to withdraw $2 million of IRA assets for only $140,000 of income tax. And he is able to make $140,000 of gifts per year for 15 years. He has gotten most of the toxic IRA asset out of his estate and has avoided a lot of income with respect to a decedent tax (IRD) for his heirs. Is there a downside? Several, actually. First, our East Coast friend loses access to his capital for 15 years. And even though he is healthy and working now, it's impossible to know how long that will be the case. He may also have given away $2 million and, thus, disinherited his heirs from those funds. If the CLAT earns 7 percent or less, there will be little, if any, capital left. And while his income tax is "only" $140,000, he still has accelerated the payment of that tax into the current year.

Conclusion

What else could he do instead? Again, several things come to mind. First, he could do a charitable IRA rollover and make an annual gift that way. Second, he could name a charitable remainder trust as the beneficiary of his IRA and allow that income stream to benefit his children and significant other. While this would delay the gift to charity, there is nothing to stop him from making annual gifts to charity from his RMDs. He could also name his alma mater as the beneficiary of the IRA and purchase life insurance to replace the asset for his heirs.

Want to know my answer to "Should I do it?" Tell me what you think. Yes or No?

About the Author

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