

## IRA Planning - Taking a Second Look at the Testamentary Charitable Remainder Unitrust

**Take-Away:** The benefit of naming a testamentary charitable remainder unitrust (CRUT) as the beneficiary of an IRA have increased with the currently prevailing higher interest rates and the SECURE Act's 10-year distribution rule which now requires annual distributions from an inherited IRA if the IRA owner died after his/her required beginning date (RBD.)

**Background:** A few years back, when the SECURE Act was first enacted, a couple of these missives were devoted to naming a testamentary charitable remainder unitrust (CRUT) as the beneficiary of an IRA to 'circumvent' the SECURE Act's new 10-year distribution mandate. Back then, the interest rates were lower than they are today, which made the annual payments from the CRUT to its lifetime beneficiary more difficult to achieve due to the Tax Code's 10% charitable remainder interest rule (more on that below.).

These days, with interest rates higher (including the IRC 7520 rate which is used to value the charity's remainder interest in the CRUT) I wondered if naming a CRUT as an IRA's beneficiary makes even more sense, since it should be easier to satisfy the Tax Code's 10% charitable remainder interest condition.

In addition, with the Final Regulations now formally adopting the *at least as rapidly rule* when the IRA owner dies after his/her required beginning date (RBD), which will cause *annual* required minimum distributions (RMDs) taken by the designated beneficiary for the mandatory 10-year distribution period (with a final lump sum payment to the designated beneficiary in the 10<sup>th</sup> year after the IRA owner's death), I wondered if the now-required *annual* RMDs over that 10-year period might make a testamentary CRUT even more attractive for a senior-decedent's IRA. See IRC 401(a)(9)(B)(i) and IRC 408(a)(9).]

**Basic CRUT Rules:** As a brief refresher, a charitable remainder unitrust (CRUT) is authorized under the Tax Code. [IRC 664.] A CRUT must make at least annual payments to its non-charitable beneficiary. The amount of each year's payment to its lifetime beneficiary must be a fixed percentage of the CRUT's property value. That annual fixed percentage payment must be at least 5% of the CRUT's initial value, but not more than 50% of that initial value. When the CRUT is funded, the actuarial present value of the amount that will ultimately pass to the charitable remainder beneficiary must be at least 10% of the initial CRUT contribution using IRS Tables regarding the life expectancy of the non-charitable

beneficiary. That minimum age is currently 28 years, using the minimum 5% annual payout for the CRUT. [IRS Publication 1458, Revenue Procedure 2023-6.]

Practical Observations: Some of the considerations that should go into whether to name a testamentary CRUT as an IRA beneficiary, or not, include the following:

**Must be Charitably Inclined:** A testamentary CRUT should probably not be considered by an IRA owner if he/she is not charitably inclined.

**May not Save Taxes:** In some cases, the use of a testamentary CRUT that is used to *spread* taxable distributions of the IRA's assets over the non-charitable beneficiary's life expectancy may not ultimately provide a greater value to the beneficiary compared to his/her use of the 'normal' 10-year distribution period that is required by the SECURE Act, where the taxable income is *bunched* over a shorter period. This is obviously the case if the individual beneficiary does not survive his/her life expectancy.

**Inflexible:** A testamentary CRUT is inflexible since the non-charitable beneficiary is only entitled to the percentage distribution amount each year since the CRUT's corpus cannot be invaded to meet other financial challenges that the non-charitable beneficiary may face.

**Creditor Protection:** The testamentary CRUT structure will provide some creditor protection to the non-charitable beneficiary, at least that is until the required annual distributions are directly made to that beneficiary, which is not the case with an inherited IRA which is not exempt from creditor claims in Michigan.

**Example:** Chris owns an IRA with cash and securities worth \$1.0 million at the time of his death. Chris could name his daughter Charla as the designated beneficiary of Chris' IRA. Charla is age 45; her life expectancy is 40.9 years.. (The designated beneficiary for purposes of satisfying the RMD is age 28 if a CRUT is named as beneficiary.) Chris could also name a testamentary CRUT for Charla's lifetime benefit, or for a fixed number of years. If a CRUT is used by Chris, assume he names a family donor advised fund as the remainder charity. For comparison purposes, assume that the IRA's assets produce an investment return of 7% each year.

**Lump Sum Distribution:** If Charla is named as the sole designated beneficiary of Chris's IRA, and she takes a lump sum distribution shortly after Chris's death, after taxes (federal and state) Charla will have about \$550,000 net available to her. Charla's effective aggregate income tax erosion rate (federal and state) is 33% when she takes a lump sum distribution.

**Distribution After 10 Years:** If Charla waits for 10 years to take a single RMD from Chris's IRA that she inherited, in doing so she exploits the SECURE Act's 10-year delayed distribution mandate, Charla's effective income tax erosion (federal and state) is estimated to be about 45% due to the *bunching* of the IRA's taxable income into a single tax year and exposing it to an effective higher marginal income tax bracket. Charla would thus receive that lump sum distribution 10 years after Chris's death, and after the erosion of income taxes, of \$806,497.

**Distribution to CRUT:** Chris's IRA names a testamentary CRUT as the designated beneficiary of his IRA. The testamentary CRUT directs a 5% annual distribution to Charla (this is the minimum payout rate from the CRUT as required by IRC 664). The CRUT makes annual payments for Charla's full expected lifetime of 40.9 years. The amount that Charla will be paid from the CRUT over her lifetime, received net, i.e., after- income taxes, will be \$1,292,937. Upon Charla's death, if she lives to her life expectancy, the amount that will be distributed from the CRUT to the family donor advised fund will be \$2,541,683. (This amount is not discounted to present value. However, the donor advised fund's remainder interest in the CRUT will pass the 10% present value remainder interest condition imposed by the Tax Code.)

**Distribution to a Fixed 20-year CRUT:** Chris's IRA names a testamentary CRUT as the designated beneficiary of his IRA. Rather than direct annual distributions from the CRUT to Charla for her lifetime, this CRUT is directed to pay the 5% annual distribution amount to Charla for the next 20 years (until she is age 65.) With this fixed- term testamentary CRUT, Charla can expect to receive, net of income taxes (state and federal) \$575,520 those 20 years. If Charla survives the full 20 years, the amount that will be distributed from the 20-year fixed term testamentary CRUT to the family donor advised fund that Chris named as the CRUT's remainder beneficiary will be \$1,387,227. (This amount is not discounted to present value. However, the donor advised fund's remainder interest in the CRUT passes the 10% present value remainder condition imposed by the Tax Code.)

**Conclusion:** IRA owners who are charitably inclined should consider (by running the numbers) naming a testamentary charitable remainder unitrust as the beneficiary of their IRA. Using the testamentary CRUT will side-step the SECURE Act's mandatory 10-year distribution rule, and the IRS's most recent interpretation of the Act which requires annual distributions from the inherited IRA if the decedent died after his/her required beginning date (RBD.)

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