

How to Collect Charitable IRA Beneficiary Designations

Traditional IRAs are funded with pretax dollars and grow tax free. Many traditional IRAs are created through rollovers of other types of qualified plans at retirement. The payouts from traditional IRAs are ordinary income because these IRAs are funded with pretax dollars.

IRAs and other qualified retirement plans now equal approximately one-fourth of household net worth. In September of 2018, the Federal Reserve estimated that net household worth in America was \$107 trillion. The Investment Company Institute (ICI) estimated in November 2018 that total retirement assets were \$28.3 trillion.

Of the total \$28.3 trillion, the two largest components are IRAs and 401(k) accounts. The ICI estimate of IRA balances is \$9.26 trillion. The 401(k) asset value in November was estimated to be \$5.35 trillion dollars.

IRA and 401(k) Bequests to Charity

With this substantial retirement plan value, there are obvious benefits for charitable individuals who transfer IRAs or 401(k) plan to charity through beneficiary designations. Because the 2019 estate exemption of \$11.4 million eliminates estate or gift tax for 99.8% of estates, the typical tax on bequests to children and other beneficiaries is income tax on traditional IRAs and other qualified plans.

The taxwise inheritance plan for a parent who wants to benefit both family and charity is to make charitable transfers through an IRA, 401(k), 403(b) or other qualified retirement plan. Because charities are exempt from tax, they may receive an IRA or other qualified plan tax-free. Given their choice, children or other heirs would prefer to receive the home, stocks, land or other assets. These assets receive a step-up in basis under Sec. 1014. Children and other heirs generally will avoid payment of tax.

However, if a parent transfers the home, stocks or land as a bequest to charity and leaves the IRA to children or other family members, they will pay a large (and unnecessary) income tax. If they were given the choice, the children or other heirs would always take the tax-free assets and prefer that the charitable transfer be funded through a traditional IRA or other qualified plan.

The ICI \$9.26 trillion value suggests there is a significant potential for both IRA rollovers and for IRA beneficiary designations. Approximately 32% of IRA assets are held by individuals age 70½ and above, according to DQYDJ.com, an Exclusive Member of Mediavine Finance. With 32% of IRA balances held by persons who are age 70½ and therefore can roll over up to \$100,000 per year, there is approximately \$3 trillion in IRAs and \$1.7 trillion in 401(k) assets that potentially can be used for qualified charitable distributions (QCDs). The 401(k) assets would need to be rolled over into an IRA, and then could be used for QCDs.

If the target market group is age 60 and above, the potential is even larger for IRA or 401(k) beneficiary designations to charity. The DQYDJ.com analysis suggests that 58% of total IRA and 401(k) assets are held by persons age 60 and above. These IRA and 401(k) owners could designate charity as the beneficiary of a portion of the \$5.37 trillion in IRA assets and \$3.1 trillion in 401(k) assets.

IRA and 401(k) Potential Value for Charity

The key to receiving these IRA rollover gifts is a multichannel marketing program with both electronic and print components. If charities have effective multichannel marketing programs and donors over age 60 designate 2% of their IRAs and 401(k)s to charity, then the amount of gifts may equal \$166 billion. Because IRAs and 401(k)s continue to grow in value, this \$166 billion amount could be substantially greater by the time the persons age 60 and over pass away.

IRA is a Trust for an Individual

IRAs are governed by Sec. 408 and Reg. 1.408 of the Internal Revenue Code and Regulations. The IRA is a trust created for the “exclusive benefit of an individual or his beneficiaries.” See Sec. 408(a). It must be a “trust created or

organized in the United States (as defined in Sec. 7701(a)(9)) for the exclusive benefit of an individual or his beneficiaries.” Reg. 1.408-2(b).

The IRA may be designated to charity. If the IRA owner designates a portion of the fund to children and a portion to charity, in order to permit children to use the “IRA stretch” plan, the IRA amount should be distributed to charity by September 30 of the year after the IRA owner passes away. Reg. 1.401(a)(9)-4, A-3(a). IRA distributions and reporting are described in IRS Pub. 590-B. When the IRA is distributed to an individual or a charity, the custodian will file IRS Form 1099R.

With the rapid growth in the number of IRA designations to charities, some nonprofits have encountered problems with the transfer from custodians to charities upon demise of the IRA owner. Some IRA custodians may require the charity to setup an IRA account, claim that the charity is subject to provisions of the Patriot Act or decide to withhold 10% of the IRA to pay income tax. Charities and their counsel must understand the correct responses to these claims in order to expedite the receipt of IRA proceeds.

IRA Collection and 401(k) Bequests to Charity

Problem: The IRA custodian claims that the charity must set up a new account.

Response: The charity is not an individual and therefore not qualified to set up an IRA account. Under Reg. 1.408-2(b), an IRA account must be for “the exclusive benefit of an individual or his beneficiaries.” A charity is a corporation and defined as a “person” under the IRC, but a nonprofit corporation is clearly not an individual. Therefore, the charity is not qualified to set up an account. The appropriate response for the custodian is to transfer the designated amount directly to the charity.

Problem: The custodian attempts to apply the Patriot Act to the charity. Some IRA custodians ask for detailed personal and financial information of nonprofit board members.

Response: The USA Patriot Act was passed in 2001 for the purpose of protecting America and reducing the risk that funds would be transferred overseas. Sec. 326 of the Patriot Act provides that “financial institutions” shall be required to exercise efforts to reduce the risk of funds being used by suspected terrorists or terrorist organizations. Patriot Act Sec. 326 applies if an individual or corporation attempts to open a bank account. The bank must maintain records to verify the person’s identity, name, address and other identifying information and ascertain whether or not the person is on the list of known or suspected terrorists.

The Patriot Act does not apply to U.S. nonprofits. First, they are not creating an account. Second, the U.S. nonprofits are not on the known or suspected terrorist list. Therefore, there is no application of the Patriot Act to the distribution of an IRA balance to a U.S. nonprofit.

Problem: The IRA custodian may withhold 10% of the distribution and send it to the IRS.

Response: U.S. nonprofits are tax exempt. While there is generally a requirement to withhold tax on IRA distributions to individuals, it is possible to elect no tax withholding on IRS Form W-4P. In any case, a qualified exempt charity is not subject to income tax and there is no requirement for withholding.

Letter to General Counsel to Facilitate IRA Collection

Some IRA custodians will promptly distribute the funds to a nonprofit, but others may delay or create roadblocks to that distribution. In order for a nonprofit to collect its share of an IRA, it may be necessary to send a letter to the general counsel of the bank or other financial custodian. Below is a specimen letter that nonprofits may modify and send to the general counsel of the IRA custodian. This letter may be modified to conform with the nonprofit’s name, address and specific goals. The donor’s name and account number also must be updated.

Specimen Letter to General Counsel of IRA Custodian

January 1, 2019

Oregon State University Foundation
123 Oak Street
Chicago, IL 00000

Dear General Counsel:

We have been informed that **Oregon State University Foundation** is a beneficiary of the IRA of **Jane Doe**. The IRA account number is **123-45-678**. We request that you liquidate the funds held for our benefit in the trust account and deliver them by check within 30 days to our organization at this address: **Oregon State University Foundation, Bequest Administrator, 123 Oak Street, Chicago, IL 00000**.

Oregon State University Foundation is not required to open an IRA account with a custodian to receive an IRA distribution. Under Reg. 1.408-2(b), the IRA account must be created “for the exclusive benefit of an individual or his beneficiaries.” A charity is a nonprofit corporation and is defined as a “Person” under the IRC, but a charity clearly is not an individual and therefore not permitted to set up a Sec. 408 IRA account. In addition, as custodian you are trustee of an IRA trust under Reg. 1.408-2(b). You are required by federal and state law to comply with the fiduciary responsibilities of a trustee. If you fail to make the distribution as required in your contract with the IRA owner, you are potentially in breach of your duty of fiduciary responsibility.

Oregon State University Foundation is not subject to the USA Patriot Act (Pub. L. 107-56). Sec. 326 of the USA Patriot Act requires banks and other custodians to determine that a person opening an account is not on the suspected terrorist list. First, IRC Sec. 408 does not permit a nonprofit to open an IRA account. Therefore, the Patriot Act does not apply to an IRA distribution to charity. Second, we are a U.S. recognized exempt charity and not on a suspected terrorist list.

Finally, IRA custodians may withhold 10% of a distribution to individuals and remit that amount to the Internal Revenue Service. We are tax exempt and elect under IRS Form W-4P to not have tax withheld. Because we are tax exempt, there is no income tax on our IRA distribution and no requirement for withholding on your part. Enclosed is a copy of our IRS tax exemption letter. Our IRS identification number is **00-1234567**.

Because we are not permitted to open an IRA account, the USA Patriot Act does not apply to a qualified exempt U.S. charity and withholding is not required, we request that you remit within 30 days the full distribution to the above address. If you are unable to distribute our vested IRA funds within 30 days, then, in a manner similar to Sec. 6662(a), we should receive the IRA funds and a 20% penalty amount. Because after the 30-day period you are in clear and obvious breach of contract and breach of trustee fiduciary responsibility due to noncompliance with the distribution terms of the IRA agreement, we will be willing to settle for the IRA funds plus the 20% penalty.

If you feel you are unable to make this prompt distribution as requested, please have your Legal or Compliance Department provide us with your legal basis for holding these funds and not distributing them to us. We remind you again that this is a trust and you are potentially subject to a breach of fiduciary responsibility claim for failure to follow the trust terms.

Sincerely,

Susan Officer

Vice President, Oregon State University Foundation

Expected Response to General Counsel Letter

This letter has two keys that encourage IRA distributions. The 30-day limit and the 20% penalty will cause the letter to be sent to the IRA custodian general counsel. Legal counsel will recognize that they do not wish to deal with a claim for breach of fiduciary responsibility. The general counsel can negotiate with the nonprofit to drop its claim for breach of trustee fiduciary responsibility and the 20% penalty in exchange for the IRA distribution. This letter should move the IRA custodian forward and encourage a prompt distribution.

The letter may be modified in the case of a 401(k), 403(b) or other type of qualified retirement account. Even with this letter, it may take a period of time for the custodian to respond.

IRA Transformative Gifts

With potential IRA and 401(k) bequests over \$166 billion, all nonprofits should encourage lifetime and testamentary IRA gifts with a full-featured marketing program. Your Boomer and Quiet Generation donors can transform your organization through these IRA gifts. With the assistance of the IRA collection letter above, your nonprofit will quickly benefit from these excellent gifts.