Yes, Virginia, It's True: There *Can* Be Life Income Gifts from IRAs (and Other Qualified Retirement Plans)

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By Jeffrey Frye, Senior Client Services Advisor, PG Calc

People do continue to ask, "can't we establish a Gift Annuity with funds from an IRA?" The short answer is that you absolutely can, and can also establish a charitable remainder trust using money withdrawn from a qualified retirement plan.

The high degree of focus these days on the so-called "Charitable IRA Rollover" (more accurately known as a Qualified Charitable Distribution or QCD) from traditional IRAs means that alternative gift plans such as this two-step process are typically overlooked. But gift planning professionals should always be aware of the full range of possibilities with donors – certainly there are some who might actually consider this combination of transactions, especially after doing an in-depth analysis.

The catch is that there will be tax on the distribution (withdrawal) from the IRA; generally, it will be taxed as ordinary income at the owner's marginal income tax bracket. The establishment of the gift annuity or charitable remainder trust, on the other hand, will result in a charitable income tax deduction for a portion of the total funding amount. Yes, there is a net tax cost for funding a life income gift with an IRA, but the donor might already be required to take the Required Minimum Distribution (RMD) if they are over 70½. This plan reduces the tax burden on the RMD, and the donor enjoys a stream of income.

If the donor is at least 59½ years old or older, he or she can withdraw any amount of money from his or her IRA without incurring any tax penalty. And this is not just limited to IRAs – generally speaking, donors above the age of 59½ can withdraw money from a variety of qualified retirement plans and use the money to establish split interest gifts.

Here's what a simple example might look like – the donor withdraws $50,000 from his or her IRA and establishes a $50,000 CGA:

Qualified Distribution from IRA	$50,000
Owner's marginal income tax bracket	35%
Net Investment Income Tax ("Medicare Surtax")	3.8%
Effective tax rate on IRA distribution	38.8%
Federal income tax on distribution	$19,400
Amount contributed to charity for CGA	$50,000
Income tax deduction for CGA	$18,589
Tax savings from CGA	$6,506
Net federal tax on combined transactions	$12,894

Please note: these figures are for a 72-year-old single donor, in the marginal federal income tax bracket of 35% and subject to the 3.8% Medicare Surtax, establishing a 5.8% CGA with a discount rate of 2.2%. The federal income tax on the distribution would be increased by a 10% penalty for early withdrawals if the donor were less than 59½ years old.

The above gift annuity results in a charitable income tax deduction of $18,589, which means the Investment in Contract is $31,411. The Investment in Contract is the present value of the projected stream of future tax-free annuity payments based on the annuitant's (donor's) estimated life expectancy.

Say that again, my friends: the value of the annuity itself is worth $31,411, which is significantly greater than – in fact, more than double - the net tax cost of the gift plan, which is $12,894.

Putting this all together, the donor withdraws $50,000 from his or her IRA (which they may be required to take as an RMD anyway) and uses the money to establish a CGA. The estimated federal income tax on the withdrawal is $19,400, but the establishment of the CGA results in a tax deduction of $18,589. That saves the donor $6,506 in actual tax dollars, so the net tax on the combined transactions is $12,894. But the gift annuity provides the donor with payments for his or her remaining lifetime, the present value of which is $31,411.

This naturally begs the question: wouldn't some donors be willing to pay $12,894 in taxes up front for a benefit whose value is at least $31,411 particularly if the donor would have to take their RMD distribution anyway? And possibly more, if the donor outlives his or her life expectancy (which we know is generally the case for gift annuity donors)?

In summary, despite the fanfare of the QCD, perhaps we shouldn’t overlook the possibility that some donors may in fact be interested in taking money out of retirement accounts and paying the taxes NOW, allowing them to establish split interest gifts that provide significant benefits to both the charities and donors over time.