Tips and Traps on Retirement Accounts and Other Charitable Beneficiary Designations

TABLE OF CONTENTS

American Institute for Cancer Research®

Major Gifts, Trusts and Bequests to the American Institute for Cancer Research

The American Institute for Cancer Research is devoted to the task of conquering our nation's most dreaded illness. Each year, the Institute sponsors important research projects at universities and research facilities across America on the cause and prevention of cancer. And it has long been a leader in providing effective educational programs on the prevention of cancer – directed to both health care professionals and the general public.

The primary focus of the American Institute for Cancer Research – in both its research projects and its educational programs – has been the role of diet and nutrition in the development and prevention of cancer. (There is scientific evidence that diet and lifestyle changes could reduce incidence of cancer by 30 to 40%.)

We are winning the war against cancer. But there is still a great need for additional scientific research on the cause, prevention and treatment of cancer. And as we learn more about the role of nutrition in the cause and prevention of cancer, our educational programs become more and more important and rewarding.

Millions of Americans provide financial support to our programs – often through tax-planned gifts, trusts and bequests. To encourage, facilitate and recognize this very important financial support, the Institute has created the League of Willful Cancer Fighters. We will be pleased to enroll in the League any client who has made or intends to make a bequest to the Institute or to name the Institute as the beneficiary of a trust, a life insurance policy, a retirement death benefit or other form of estate gift. We invite you or your client to call us at your convenience.

To encourage generous gifts to the Institute and other charities, we have prepared this booklet to help attorneys and other financial advisors understand all the important tax and financial rewards Congress has provided. Our staff can provide the exact tax and financial consequences of any gift, trust or bequest your clients may want to consider. And because we are so active in this specialized field, we can provide whatever technical and practical information you may request for planning and drafting a charitable gift arrangement that will provide your clients both the greatest personal satisfaction and the greatest tax and financial rewards.

Please feel free to call the Office of Gift Planning at any time. Our toll-free telephone number is 1-800-843-8114. And please . . . if the opportunity presents itself, inform your clients about how a gift, trust or bequest to the American Institute for Cancer Research can further the fight against cancer and also enhance their personal tax, investment, retirement and estate plans.

TIPS AND TRAPS ON RETIREMENT ACCOUNTS AND OTHER CHARITABLE BENEFICIARY DESIGNATIONS

Wills and revocable living trusts historically have been the mainstays of estate planning. But more and more wealth is passing by way of payable-on-death or transfer-on-death arrangements. In some areas, even real estate, motor vehicles and other personal property can be transferred at death through beneficiary designations. Indeed, it's not uncommon for the greater part of an estate (100% in some cases) to be distributed outside a decedent's will or revocable living trust.

Increasingly, clients who wish to make bequests to organizations such as the American Institute for Cancer Research may wish to employ beneficiary designations on life insurance policies, bank accounts, retirement plans and brokerage accounts. Reasons include simplicity, low (or no) transaction costs, and often because "that's where my money is." On the other hand, all these beneficiary arrangements deserve the same degree of planning as charitable bequests in wills and trusts.

This booklet is designed to help advisers guide philanthropic clients who are considering charitable beneficiary designations for AICR in a manner that accomplishes their goals and objectives – and avoids legal and practical difficulties.

PLANNING FOR BENEFICIARY DESIGNATIONS – IN GENERAL

Clients may have charitable and noncharitable beneficiary designations in place for a wide variety of assets and accounts. It's vital that these designations be coordinated with the client's will, living trust and joint ownership arrangements. Beneficiary designations should also be reviewed and revised on a regular basis, just like other estate documents.

Beneficiary designations generally can be made from accounts having more than one owner, and multiple beneficiaries may be named. Designations should foresee the possibility that a beneficiary may predecease the client. It's true the client could simply fill out a new form when a beneficiary dies, but what if the client has become disabled or simply forgets to make needed changes? The account could become part of the owner's probate estate under state law or terms of the beneficiary form.

Where multiple beneficiaries are named, beneficiary forms or even state law may require that a deceased beneficiary's share will pass to the survivors. Clients may wish to name contingent beneficiaries, such as the heirs of a deceased beneficiary, or an alternative beneficiary, such as AICR, to receive benefits. Inquiry should be made whether "per stirpes" language is permitted, enabling a predeceased beneficiary's descendants to inherit a share of the account, insurance policy or other assets.

Clients need to be aware that nonprobate beneficiary designations supersede contrary or overlapping provisions in a will, and that some transfers are subject to legal restrictions. For example, a spouse's consent is required to pass a qualified retirement account (but not an IRA) to someone other than the surviving spouse, including charities.

Spouses in most states are entitled to an "elective share" amounting to one-third to one-half of their spouses' estates – including assets that don't go through probate. The Uniform Probate Code provides a sliding-scale elective share to surviving spouses, ranging from 3% of the "augmented estate" after one year of marriage to 50% after 15 years. The augmented estate includes the decedent's net probate estate, nonprobate transfers to others (including to the surviving spouse), and the surviving spouse's property and nonprobate transfers to others (UPC §2-202). Spouses in community property states generally are entitled to one half of the assets acquired by the married couple while living in community property states.

Will provisions should be taken into account when coordinating testamentary transfers. For example, life insurance and retirement plan benefits generally pass outside probate. If the will directs that estate administration expenses and taxes are to be paid by the probate estate, a child receiving probate assets may pay taxes and other costs on assets received by siblings via beneficiary designations.

Clients also should weigh the tax implications of naming beneficiaries, particularly as to IRAs and other retirement accounts, which can be liable for both federal and state income taxes and estate taxes, as well – except for amounts that pass to qualified organizations such as AICR. (See the discussion that follows.)

Special planning will be needed if a minor is a beneficiary. A letter designating the minor's custodian should be provided to the financial institution; a guardian or conservator may need to be appointed in some circumstances.

Financial accounts generally can be made payable to trusts established for beneficiaries, including charitable remainder trusts. All of these special situations will need to be planned in consultation with the financial institution that eventually will distribute account balances.

Beneficiary forms typically require beneficiaries' names, addresses, dates of birth, Social Security or tax ID numbers and sometimes relationship to owner. (Information for listing AICR as a beneficiary appears on the back page of this booklet.) Forms are often available online from financial services companies but need to be mailed or faxed to the company.

BENEFICIARY DESIGNATION TOOLS

Payable on Death Accounts. Clients can name beneficiaries for just about any financial arrangement, including savings and checking accounts, CDs, credit union deposits and others. These are commonly referred to as payable on death (POD) accounts, although some financial institutions have different arrangements for transferring account balances to beneficiaries (see below).

Clients may ask whether fees and penalties can be assessed when CDs or other time deposit accounts are paid out to beneficiaries. According to the American Bankers Association, banks are not required to waive early withdrawal penalties for beneficiaries when the account owner dies. But waivers are specifically permitted under the Federal Reserve regulations for time deposit accounts. Clients should ascertain whether their banks allow penalty-free withdrawals at death.

Some POD forms provided by financial institutions state that remaining account balances will be shared equally among named beneficiaries. Others permit account owners to list different percentages for each beneficiary. Some state laws (Florida, for example) require that multiple beneficiaries receive equal shares from both POD and TOD accounts.

POD Alternatives. State banking laws vary as to how CDs and other accounts can be made payable on death to a beneficiary. At some financial institutions a POD transfer may be characterized as a "Totten Trust" or "Self-Declaration Trust" or "in trust for" (ITF) arrangement.

Joint ownership with right of survivorship is another option. Older parents sometimes name a son or daughter as joint owner of checking or savings accounts, to enable the child to receive the account at death or pay the parent's bills. But a bankruptcy proceeding against the son or daughter could freeze the account and deny access to the parent or child for a period of time. A POD designation, Totten Trust, self-declaration trust or "in trust for" arrangement would protect the funds while the parent is alive and provide a nonprobate transfer.

Transfer on Death of Securities. Securities held in brokerage accounts generally can be distributed to beneficiaries under Transfer on Death (TOD) registrations. Most states have adopted the TOD Security Registration Act, although brokerage firms are not required to offer TOD registrations.

TOD beneficiary designations are accomplished by filling out TOD registration request forms, which are available online from many brokerage firms. Required information includes marital status, beneficiary names and relationships, distribution percentages and, where applicable, signed spousal waivers for community property states.

Note that TOD beneficiaries must take steps to re-register the securities in their names. This typically involves sending a copy of the death certificate and an application for re-registration to the transfer agent.

TOD Transfers of Real Estate. Real estate owners have essentially five ways to arrange for property to pass to someone else upon death. They can:

- Name a joint owner on the deed who will have "right of survivorship";
- Transfer title to a revocable living trust that names a beneficiary;
- Make provisions in their wills;
- Allow state intestacy laws to decide who receives the property (not recommended); or,
- In the following states, name a "transfer on death" (TOD) beneficiary on the deed: Arizona, Arkansas, Colorado, District of Columbia, Hawaii, Illinois, Indiana, Kansas, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Oregon and Wisconsin.

Landowners are not required to reside in one of these states to make a TOD transfer of real estate that they own there, but this kind of transfer won't work for property owned in other states. TOD deeds must comply with state laws and be recorded like other types of deeds.

Charities have differing gift acceptance policies regarding real estate and it's important to coordinate with the organization. If the charity disclaims a bequest of real estate, the property will become part of the donor's probate estate, unless a contingent beneficiary has been named.

Life Insurance. Donors can name qualified organizations such as AICR as beneficiaries of life insurance policies – with a right to change the beneficiary or surrender the policy at any time – and the proceeds will be free of state and federal estate taxes. Donors also can name AICR as a co-beneficiary with a family member – or as a contingent beneficiary to take the proceeds only if the primary beneficiary dies before the insured. The full amount passing to AICR will qualify for an estate tax deduction.

Naming a qualified organization as beneficiary does not give rise to an income tax deduction – unless charity is also named owner and sole beneficiary of the policy. Donors could then qualify for deductions for the fair market value of the policy or their cost basis, whichever is less, and future premium payments would be tax deductible.

As noted, it is not necessary to give AICR the entire proceeds of a life insurance policy in order to achieve estate tax savings. A gift of a partial interest in a policy may, if made through a charitable gift annuity, qualify for an estate tax deduction. If a deduction is allowable, the gift is valued actuarially according to government tables.

A donor can name a trust as the beneficiary of a life insurance policy and direct the trustee to make specified payments to a friend or family member for life and to pay the remaining proceeds to AICR at the beneficiary's death. For example, the trust instrument would direct the trustee to collect and invest the proceeds of a $250,000 policy, to pay 6% annually to a husband or wife for life and to pay AICR whatever remains in the trust when he or she dies. The present value of AICR's right to receive the proceeds at a later time will be immediately deductible for estate tax purposes.

Donor Advised Funds. Donors who contribute to donor advised funds often may designate one or more charities to receive any balances remaining in their accounts at death. Vanguard, Schwab, Fidelity and other companies with charitable gift funds permit such designations, subject to terms of the fund agreements, and community foundations and other donor advised fund sponsors often have similar arrangements. Clients should check with their account managers for details and the necessary forms. Amounts passing to AICR or other organizations would be free of federal and state estate taxes.

TOD Registration of Vehicles. Thirteen states offer residents the ability to name a death beneficiary on motor vehicle registration papers: Arizona, Arkansas, California, Connecticut, Delaware, Illinois, Indiana, Kansas, Missouri, Nebraska, Nevada, Ohio and Vermont. Owners of automobiles and other vehicles should request appropriate forms from the department of motor vehicles.

TAX-FAVORED BENEFICIARY ARRANGEMENTS

Where possible, donors should leave to charity property that would create income tax liability for other beneficiaries. That generally means income in respect of a decedent (IRD) – items of income earned by a decedent before death but paid to his or her estate after death. Such income is includable both in the taxpayer's gross estate and in the estate's income – or in the income of the person who receives it.

Charities usually do not pay income taxes and therefore keep every dollar of such tax-burdened bequests. Furthermore, a bequest of IRD can create both an estate tax charitable deduction and an income tax charitable deduction for the estate [IRC §642(c)(1)]. IRD can be left to charity by will, but certain assets are best transferred via beneficiary designation.

Retirement Accounts. Clients can leave part or all of an IRA or other retirement account to a qualified organization and escape both income taxes and estate taxes on amounts passing to charity.

Charitable transfers are usually made by means of a beneficiary designation form provided by the account custodian. This nonprobate arrangement ensures both an estate tax charitable deduction [IRC §2055(a)(2)] and avoidance of income tax on amounts distributed to the tax-exempt organization. If the donor is married, the spouse's written consent will be required to make charitable distributions from qualified retirement plans (not required for IRAs).

Donors can name charity as beneficiary of a percentage of their IRAs without the need to split the IRA into multiple accounts for family and charity. If a charity that is a co-beneficiary of a retirement account receives its distribution by September 30 of the year following the year of the donor's death, individual IRA beneficiaries may stretch distributions over their life expectancies. If charity fails to cash out in a timely manner, IRA payments would be accelerated as follows:

- *Donor dies before required beginning date*. IRA funds must be paid out within five years to all beneficiaries.
- *Donor dies after required beginning date*. Distributions will be made over five years or the life expectancy of a person the donor's age at his or her death, whichever is longer. That life expectancy will exceed five years for all individuals up to age 89.

Donors can arrange for retirement accounts to pass to a charitable remainder trust that would make lifetime payments to family beneficiaries, with eventual benefit to charity. The trust would reduce federal estate taxes and absolutely no income taxes – state or federal – would be triggered upon death. Substantial tax savings also would occur if retirement assets were left to a charitable remainder trust from which income is paid to heirs over a term of years. A private letter ruling also approved a testamentary charitable gift annuity funded by an IRA distribution (PLR 200230018).

Note that a charitable remainder trust is generally not feasible if the trust is to last for the lifetimes of very young beneficiaries, due to the 10% minimum charitable remainder requirement [IRC §§664(d)(1)(D) and 664(d)(2)(D), 664(d)(4)].

If the 10% test is a problem, donors might consider leaving charity a portion of the IRA outright with the remaining portion passing to an eligible "look-through" trust to benefit grandchildren or other young beneficiaries. A term-of-years charitable remainder trust would also be a solution, especially where the donor wishes to benefit a mix of older and younger individuals, if the donor is agreeable to limiting distributions to a maximum of 20 years.

Donors who wish to use a retirement account to benefit both a spouse and charity have several choices:

- Make charity a partial beneficiary of the account and leave the rest to the spouse, who would then roll over the benefits into his or her own IRA or receive distributions over his or her life expectancy under the general stretch-out rules for inherited accounts (because the surviving spouse is not the sole beneficiary, life expectancy can't be recalculated annually).
- Alternatively, an account can be split into two accounts, one naming charity as beneficiary and the other naming the surviving spouse.
- Leave part or all of the retirement account to a testamentary charitable remainder trust in which the spouse is the sole beneficiary (required for qualification for the estate tax marital deduction).

Ideally, where both spouses are committed to the same organization, the surviving spouse would be made the sole beneficiary of the IRA, with the expectation that he or she would leave part or all of their rollover IRA to the charity. Of course, the first spouse to die has no absolute certainty that charity eventually will benefit under this "reliable spouse" strategy. So a CRT distribution may have the best practical and tax results.

Commercial Annuities. Some commercial annuities make payments for a person's lifetime but also provide survivorship benefits or partial refunds upon death. These amounts may be partly or wholly treated as IRD. Designating charity to receive such benefits can avoid both income taxes and estate taxes.

U.S. Savings Bonds. It is not possible, under Treasury regulations, to designate organizations as either joint owners or death beneficiaries of savings bonds.

"The issue or reissue of a bond in the name of an organization (charitable and others) as a co-owner or beneficiary is not permitted; such forms of registration are limited to natural persons. Reissue of a bond in the name of an organization to designate another organization as owner is not permitted, but a bond that an organization receives as a distributee of a decedent's estate may be reissued in its name." 31 CFR §315.

On the other hand, bonds can be left to AICR in a will or through a revocable living trust, so long as the bonds do not have a surviving joint owner or death beneficiary. At death the executor would file form PDF 1455 to have the bonds reissued in charity's name. AICR can redeem bonds received from an estate without owing income tax – and generate an estate tax charitable deduction, as well. It is also possible to leave bonds to a charitable remainder trust that will pay income for life to a family member, with later benefit to the war against cancer. Bonds can also be bequeathed for the purpose of establishing a charitable gift annuity with AICR.

Conversations with Treasury Department staff indicate that savings bonds can also be transferred during life to a charitable remainder trust in which the bond owner is both grantor and beneficiary. The officials explained that, unfortunately, the donor would be taxable on any unreported interest on the bonds in the year they are transferred to a CRT. Such additional income could be offset, at least in part, by the donor's income tax charitable deduction for charity's remainder interest.

MAKING BENEFICIARY FORMS FIT DONOR NEEDS

The beneficiary forms associated with life insurance, retirement accounts, certificates of deposit and other financial arrangements are often plain-vanilla, one-size-fits-all documents that need to be adapted to achieve philanthropic goals.

Clients should contact their account manager or customer service representative if they wish to name a trust as beneficiary, or make a designation that goes beyond just the name of an organization. For example, it's possible to name AICR to receive part or all of an IRA in exchange for a charitable gift annuity payable to a surviving spouse or others. But special instructions would need to be included on an attachment to the beneficiary form. For example:

> *Attachment*
>
> The American Institute for Cancer Research (AICR), 1759 R Street, NW, Washington DC, TIN #52-1238026, is designated as payable-on-death beneficiary of any remaining balance in my account, #12345678, on the condition that AICR pay my brother, George Wilson, an annuity at the same rate AICR pays to other annuitants who are the age of George at the time of my death. In the event AICR does not accept this transfer with all its conditions, I direct that 50% of the account balance pass to George and 50% to AICR."

Contributors sometimes wish to leave AICR a particular dollar amount from their IRAs but find that the beneficiary forms permit IRAs to be divided up only by percentages or fractions. One solution is to state that AICR is to receive a certain percentage (25%, for example) "not to exceed $50,000" (or some other dollar amount likely to be less than the stated percentage). Another work-around is to leave charity a fractional amount in which the numerator of the fraction is a specific dollar amount and the denominator is the balance remaining in the account at death.

It's important to ensure that the company understands and consents to any special beneficiary language; an attorney should examine these documents as well.

REVIEW BENEFICIARY DESIGNATIONS REGULARLY

It's important to review and update beneficiary designations with clients on an annual basis, along with wills, revocable living trusts and other estate documents. Revisions may be needed as a result of:

- marriage or divorce, or the death of a spouse
- birth of a child or grandchild
- a child reaching adulthood
- changes in the value of the client's assets
- acquisition of new assets by gift or inheritance
- giving away or selling assets with beneficiary designations

- death of a beneficiary
- changes in the needs of beneficiaries
- a decision to make additional bequests, such as a gift to AICR.

If changes are needed, clients should request and complete new beneficiary forms. Copies of the beneficiary forms should be kept on file with other estate documents. Clients should not assume that banks, insurance companies and other financial services organizations have up-to-date information on their beneficiaries. They should verify that the company's beneficiary information matches what they have on file.

A LASTING LEGACY TO FIGHT CANCER

Ruth and Deborah were sisters who maintained a joint savings account until last fall, when Ruth passed away, a victim of ovarian cancer.

Deborah, herself a cancer survivor, became the sole owner of the account and recently told her financial planner that she would like to arrange matters so that, upon her death, anything left in the savings account will pass to AICR as a memorial to Ruth and to Deborah's strong personal interest in cancer research.

The financial planner suggested that Deborah ask the manager of her bank what procedure would be appropriate for making AICR the death beneficiary of her account, which could be a POD designation, Totten trust or "in trust for" arrangement.

Deborah is representative of a growing group of people who share the belief: "I would like to leave a legacy from my estate plan that hastens the day when cancer ceases to be a threat to so many people."

We hear those words from time to time, and are always glad to point out that friends can help win the war against cancer simply by filling out a form making AICR their beneficiary. Almost any financial arrangement that allows the naming of a beneficiary can be repurposed to benefit cancer research. In summary, here are common ways to designate AICR as a beneficiary:

- *IRAs, 401(k) plans, 403(b) plans or other retirement savings arrangements.* Naming AICR as beneficiary of part or all of a retirement account can save income taxes, estate taxes or both. Simply ask the custodian or trustee of the account for a new beneficiary form. As noted earlier, except for IRAs, married donors will need the written consent of their spouses to make gifts from retirement accounts. Check with the account manager.
- *Financial accounts.* People who have financial accounts at banks, savings and loan associations and credit unions generally may direct that their deposits (checking, savings, share accounts, certificates of deposit) be paid on death to a particular individual – or to a worthwhile cause such as AICR. The designation can be revoked any time prior to death and in no way affects the depositor's control over the funds in the account.
- *Brokerage accounts.* Clients who own stocks, bonds or mutual fund shares in brokerage accounts can name AICR as TOD beneficiary.
- *Life insurance* – One of the easiest and most cost-effective ways to include AICR in estate plans is through life insurance. AICR might be the beneficiary or alternative beneficiary of a policy that is no longer needed for family security. Keep in mind that AICR can be the beneficiary of just part of a policy (50%, for example), and that gifts from group life or term policies are possible.
- *Commercial annuities.* Some commercial annuities make payments for a person's life-

time but also provide survivorship benefits or partial refunds upon death. Designating AICR to receive such benefits can avoid both income taxes and estate taxes.

- *Donor advised funds.* Donors who contribute to donor advised funds often may designate one or more charities to receive any balances remaining in their accounts at death.

- *U.S. savings bonds.* While it's not possible to name organizations as either joint owners or death beneficiaries of savings bonds, bonds can be left to AICR in a will or through a revocable living trust, so long as the bonds do not have a surviving joint owner or death beneficiary.

The War Against Cancer

When you have the occasion to draft a trust or a bequest for a client who wants part of his or her estate to support the war against cancer, our correct legal name is:

"The American Institute for Cancer Research, a not-for-profit corporation located in Washington, DC."

Please feel free to contact our Office of Gift Planning for additional information about the mission and the future plans of the American Institute for Cancer Research.

Our Office of Gift Planning will be pleased to help you plan a trust or bequest that will accomplish the specific objectives of your client. We can also provide the exact tax consequences of any trust arrangement a client may want to consider. There is no other obligation for this service.

Information for the Attorney or Advisor

- AICR's official name:
  American Institute for Cancer Research
- AICR's mailing address
  1560 Wilson Blvd, Suite 1000,
  Arlington, VA 22209
- AICR's phone number:
  800-843-8114
- AICR's identification:
  A not-for-profit organization under Section 501(c)(3)
  of the Internal Revenue Service Code
- AICR's tax-exempt IRS number:
  52-1238026

The information and examples provided in this booklet are for information and discussion purposes only. The examples are hypothetical, and the facts and tax consequences of individual transactions may vary from person to person. Each estate planning professional must independently determine and evaluate the tax and financial consequences of each individual situation.

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1-800-843-8114
www.aicr.org/planned-giving/estate-planning

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