

The Blitz

September 2018

Information on Tax and Estate Planning from the
Masonic Charities of the Grand Lodge of Pennsylvania

What to Do with the Tax Toxic IRA?

Question 1: My travels take me to Florida on a regular basis since it is the number one destination for PA Masons and their spouses. For years I have been visiting with Tom and Ann at their winter home in Ft. Myers, FL. Tom and Ann had a residence in Sewickley because Tom had worked in Pittsburgh for many years for a large steel company. When Tom retired, he rolled all his savings in his company 401(k) plan into an IRA. He had a solid financial advisor in Naples, FL and his IRA was worth around \$3M when he suddenly passed away from a massive heart attack last February. I flew down to

visit with Ann just after Tom's passing to console her and help her with the estate which mainly consisted of the FL and PA properties and Tom's IRA. Ann wanted to know what to do with the IRA for now and upon her passing. I told her she had several options to consider based upon her personal goals and who she wants to leave the IRA with.

**FOR THE FIRST TIME
IN OVER A DECADE,
charitable gift annuity rates have
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One-Life Gift Annuity			Two-Life Gift Annuity		
Age	Old Rate	NEW Rate	Ages	Old Rate	NEW Rate
70	5.1%	5.6%	70 & 75	4.8%	5.2%
75	5.8%	6.2%	75 & 82	5.4%	5.8%
80	6.8%	7.3%	80 & 88	6.3%	6.8%
85	7.8%	8.3%	85 & 90	7.3%	8.0%
90+	9.0%	9.5%	90 & 93	8.7%	9.3%

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Masonic Charities always recommends consulting with your professional advisor when considering any planned gift.



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Answer: As more retirees roll over their 401(k) plans into IRAs, Ann's particular situation has become quite common. I spend more time reviewing estate plans with significant IRAs than any other asset among individuals in their 60s and early 70s. The problem with IRAs are that they are "tax toxic", meaning the assets can be subject to federal estate and income tax and PA inheritance tax at the same time. In some cases, the tax could be over 50% of the value of the IRA when a Pennsylvania resident leaves this asset to certain classes of individuals. For retirees living in other states, the total could be even higher. Luckily, with some proper planning, taxes can be reduced to manageable levels. Continue inside to read what I suggested.

Continued inside

1. Get Professional Help. Since the IRA was Ann's primary asset, I told her to see her financial advisor to work on rolling the IRA into her name and devise a plan for investing the asset to provide for her future needs. Since Ann wanted to continue pledging to her church and making an annual gift to the Masonic Villages, I suggested she talk to her advisor about making qualified charitable distributions from the IRA to pay for such gifts since she was older than 70 ½ and the distributions were nontaxable. Note that if Ann lived in another state, such as New Jersey, the state might tax the distribution given to charity.

2. Provide for Heirs and Charity Ann wanted some suggestions for leaving the remainder of the IRA to her heirs and charity upon her passing. She wanted to leave part of the IRA to her son, Steve; her niece, Betty; and then her church and Masonic Villages. I told Ann a short primer in the various tax laws would be helpful in how to give leave her IRA to heirs and family.

a. Federal Estate Tax-An IRA could be subject to Federal Estate tax if the Estate is worth more than \$11.2M. Since Ann's estate was worth less than \$5M, this was not an issue.

b. Federal Income Tax-Unlike many assets that pass free of income taxes to heirs at death, the IRA comes fully loaded with income taxes on any beneficiary, except charity, that receives distributions from the IRA.

c. PA Inheritance Tax-Since Ann only wintered in FL and was still a resident of PA, if she passed before taking up residence in FL (which does not have any death tax), her estate would be subject to the dreaded PA inheritance tax which will tax assets her son receives at 4 ½% and 15% of the value of any assets her niece receives. Luckily, the church and Masonic Villages are not subject to tax since they are qualified charities.

d. Pennsylvania Income Tax-Pennsylvania has a rule that does not tax 'income in respect of a decedent.' The balance of the IRA at death is clearly exempt from Pennsylvania income tax. Whether post-death earnings are exempt is uncertain, but most practitioners believe that none of the inherited IRA

is taxed in PA.

3. Splitting Up the IRA. Ann suggested splitting up her IRA into four beneficiaries. She wanted 50% of the IRA or around \$1.5M to go to her son, 25% of the IRA or around \$750,000 to go to her niece, and the remaining 25% to be divided equally between her church and Masonic Villages. This meant 50% of the IRA was subject to a 4 ½% inheritance tax for the son; 25% of the IRA was subject to a 15% inheritance tax for the niece and then no tax for the remaining 25% to the charities. That is a whopping \$180,000 in inheritance taxes just for the IRA. Just think. If Ann became a Florida resident, the death tax would be \$0 on the IRA, since FL does not have death taxes. HOWEVER, the son and niece will pay federal income on the distributions at ordinary federal income tax rates. At a 32% bracket (remember, the beneficiaries will be receiving significant IRA distributions) the approximate income tax burden is \$720,000. If the beneficiaries live in high tax rates, the income tax burden could be \$900,000. The total tax burden is nearly \$1.1 million.

4. The CRUT Alternative. If Ann distributed the IRA to one or more charitable remainder trusts instead of any direct contribution to charity, the inheritance tax burden is roughly the same; the charitable deduction just moves to the CRUT, assuming the charitable remainder interest is solved to have a 25% value. HOWEVER, over time the income tax savings for the individual beneficiaries is quite attractive because perhaps two thirds of the distributions from the CRUT would be taxed at 15%, the capital gains tax rate. The tax savings are roughly \$270,000. There are a number of additional advantages to a CRUT, moreover, such as creditor protection.

5. One More Problem. Ann then complained to me that she wasn't keen on her niece getting her share outright since she never visits or calls Ann, or even sends thank you notes for the checks she writes Ann on her birthday (this is a common method for getting tossed out of someone's estate). Ann is also repulsed by Betty's party lifestyle in California from the pictures she sees of her on her Facebook page (another lesson for the unsuspecting). She

asked if I had any suggestions on how to provide Betty with a limited stream of income instead of an outright gift. I told Ann she could transfer Betty's 25% of the IRA to a charitable remainder trust for a period of years up to 20 years and pay her 5% of the value of trust each year and then have the remaining assets go to charity upon the end of the term of the trust. Ann liked this idea, particularly because she saw that Betty needed protection from creditors.

6. Final Thoughts. After discussing her options with Ann, I sent her to see an attorney in Pittsburgh that concentrates in Estate Planning, so she could

help Ann develop a plan that met her needs. For my readers, you can observe from this scenario that getting the right advice for managing and disposing with an IRA is critical. I only touched on the surface of the topic in this case. Please make sure you work with someone that understands the tax complexities of IRAs if you have this kind of asset in your estate. 25% of the IRA to a charitable remainder trust for a period of years up to 20 years and pay her 5% of the value of trust each year and then have the remaining assets go to charity upon the end of the term of the trust. Ann liked this idea, particularly because she saw that Betty needed protection from creditors.

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Question 2: Each year, I visit my friend, Joe, in LA who was married to his second wife, Marie, after being widowed for several years. Joe isn't wealthy, but he lives comfortably in his small abode. He has a son, Eric, and a daughter, Mary, from his first marriage who he plans to make sure receives the bulk of his inheritance. He is a 60-year Mason and wants to make sure the Masonic Children's Home receives part of his estate. He confided that he wasn't sure if his new wife would honor his request and wondered if he should do anything now to make sure his wishes were carried out. He asked me if I could give him some suggestions on what to do.

Answer: Joe is not alone, as many senior citizens today remarry after their spouse passes away rather than living the rest of their life in solitude or with an unmarried companion. However, the vows of marriage create certain challenges for the unwary that if not properly addressed could result in unhappy outcomes for their heirs. For Joe, I had several considerations:

1. The Prenuptial Vs. Postnuptial Agreement. I told Joe that I read a whopping 67% to 80% of second marriages land in divorce so a postnuptial agreement

should maybe be considered (it was too late for a prenup since they were already married, but prenups are generally easier to enforce than postnups due to the higher fiduciary requirement to care for a spouse once married). Each state is different on postnups and California, as expected, is one of the most difficult states to enforce postnups. The advantage of the postnup for Joe is he could enter into an enforceable agreement with Marie determining how his assets are to be distributed if he predeceases Marie and thereby ensure that his kids are taken care of. Joe said he suggested the postnup option with Marie and she wasn't interested especially since he brought most of wealth to the family (nothing like an honest wife).

2. Preparing an Estate Plan for Marie and the Kids. With the postnup idea off the table, I suggested that Joe consider seeing an attorney to prepare an estate plan that will take care of Marie yet provide for the kids. I suggested that he involve Marie in the process if he wants to avoid trouble down the road. Joe told me he would prefer to give Marie a couple bucks and then give the rest to the kids. I reminded Joe that Marie has the right to a spousal share of the estate (usually 30% or more depending upon the state) no matter what he does and he needs to take that into consideration when preparing his estate plan. Joe said he had a house worth about a

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Ask Alvin In Person!

Catch up with Alvin in person to learn updates on the Masonic Charities of the Grand Lodge of Pennsylvania and more about tax and estate planning.

Sept. 11 - 15, San Jose, CA

Sept. 30 - Oct. 3, Orlando &

Ormond Beach, FL

Oct. 8 - 12, Raleigh & New Bern, NC,

Myrtle Beach, SC

Oct. 21 - 26, San Antonio & Dallas, TX;

Oct. 30 - Nov. 3, Tampa, FL

Dec. 3 - 7, West Palm, FL



As Chief Gift Planning Officer of the Masonic Villages in Pennsylvania, Alvin H. Blitz, Esq., serves the Masonic Charities of the R. W. Grand Lodge of Pennsylvania, which consists of the Masonic Villages, the Masonic Children's Home, the Pennsylvania Masonic Youth Foundation, the Masonic Library and Museum of Pennsylvania and the Masonic Charities Fund. Attorney Blitz holds a Bachelor of Science degree from the University of Scranton, a Master of Arts degree from

Fairleigh Dickinson University, and a Juris Doctorate from Dickinson School of Law. He has given estate planning seminars throughout the country and is a member of Carlisle Lodge No. 260, Carlisle, Pa.

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