

The Blitz

December 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?

Dear Reader:

Previous articles in *The Blitz* have been shorter and mixed with some humor to prevent the reader from nodding off. The current article about IRAs is a complex topic which requires a more serious tone and expertise. Thus, it is longer and more technical, but contains valuable information – so please, bear with me. As always, feel free to contact me via email with your questions and comments. We will be back to our more entertaining format in the next issue.

Calvin H. Blitz

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. Tom and Ann had a residence in Sewickley, Pennsylvania, 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, and his IRA was worth around \$3 million 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 support her and help her with the estate, which mainly consisted of the Florida and Pennsylvania 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.

Continued inside



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 is 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.

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 70½,

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 requested 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 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 \$11.2 million. Since Ann's estate was worth less than \$5 million, 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 Florida and was still a resident of Pennsylvania, if she passed before taking up residence in Florida, (which does not have any

death tax), her estate would be subject to the dreaded Pennsylvania inheritance tax, which would tax assets her son receives at 4½% 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 – 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 Pennsylvania.

3. Splitting Up the IRA.

Ann suggested splitting up her IRA into four beneficiaries. She wanted 50% of the IRA, or around \$1.5 million, 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 4½% 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 Florida does not have death taxes. HOWEVER, the son and niece would pay federal income tax 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 over the payment period is \$720,000. The total tax burden could be \$900,000 on a \$1.5 million IRA. WOW!

4. The Charitable Remainder Unitrust (CRUT) Alternative.

I then discussed with Ann some of the benefits of using a CRUT as an alternative for making outright gifts to her heirs and charities. Most importantly those included: (1) for a PA resident a reduction in the inheritance tax for part of the amount distributed to a CRUT; (2) potential income tax savings over time for capital gains distributions to heirs at 15% versus a potentially much higher

income tax rate for an IRA; (3) protection from creditors of heirs; (4) professional management by the trustee of a CRUT; and (5) providing distributions of income for the life of an heir or over a fixed period of years rather than giving immediate access to the entire IRA distribution.

5. One More Problem.

Ann then expressed to me that she wasn't keen on her niece getting her share outright, since she never visits or calls or even sends thank you notes for the checks she writes Betty on her birthday (this is a common method for getting tossed out of someone's estate). From the pictures she sees of her niece on Facebook, Ann is also troubled by Betty's life choices (another lesson for the unsuspecting). She said that she liked that the CRUT provided 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 up to 20 years, 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 and professional money management.

6. Final Thoughts.

After discussing these options with Ann, I sent her to see an attorney in Pittsburgh who 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 of assets in an IRA is critical. I only touched on the surface of the topic in this case. Please make sure you work with someone who understands the tax complexities of IRAs if you have this kind of asset in your estate.

Neither Masonic Villages of the Grand Lodge of Pennsylvania nor Alvin H. Blitz, Esq. provide legal, financial, or tax advice. None of the information in The Blitz should be deemed legal, financial, or tax advice or acted upon by any person without prior consultation with appropriate professional advisors.

The official registration and financial information of Masonic Charities may be obtained from the Pennsylvania Department of State by calling toll-free, within Pennsylvania, 1-800-732-0999. Registration does not imply endorsement.

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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.

Jan. 13 - 19, The Villages, FL

Jan. 26 - Feb. 2, Phoenix, AZ

Feb. 10 - 14, Ft. Myers, FL

March 3 - 7, San Diego, CA

March 21 - 24, Houston, TX



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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