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Bequeathing IRAs: The Case for Charitable Remainder Unitrusts

By Clifford Meyer

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Bequeathing IRAs: The Case for Charitable Remainder Unitrusts

By Clifford Meyer

Clifford Meyer is a partner in Montgomery McCracken Walker & Rhoads LLP. The views and opinions expressed in this report are his own and do not necessarily reflect the official policy or position of the firm.

In this report, Meyer focuses on the economic advantage of the charitable remainder unitrust's ability to distribute capital gain income. He also reviews several other benefits and potential objections to the strategy, particularly the mortality risk.

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I. A Bold Claim

For most healthy adult children of upper-middle-income families, the after-tax amounts to be received over a lifetime from an inherited IRA[1] will be equivalent to the after-tax distributions made by a charitable remainder unitrust (CRUT) that receives the same IRA for their benefit.[2] Conventional wisdom holds that "stretching" an IRA — taking only the required minimum distribution (RMD) — produces an unbeatable tax deferral advantage. However, bequeathing an IRA through a CRUT is often a superior plan because distributions from a CRUT can be taxed at capital gains rates.

II. The Basic Comparison

A. Brief Discussion of Method, Assumptions

My claim primarily rests on a side-by-side comparison of the net present value (NPV) of the after-tax distribution streams from an inherited IRA and a CRUT structured to isolate the effects of federal tax rules. The following are my baseline assumptions for comparisons: (1) an owner dies with an IRA worth $500,000; (2) investments earn a constant 5.5 percent total return after expenses; (3) the beneficiary is in the 33 percent ordinary and 15 percent capital tax brackets; (4) the net investment income tax rate is 3.8 percent; (5) no state, local, or death taxes apply; (6) all non-IRA-source distributions are subject to the net investment income tax;[3] and (7) the unitrust rate changes with the beneficiary's age to produce a charitable remainder interest of 10 percent.

Given a constant net investment rate and a constant ordinary income tax bracket, the NPV of after-tax distributions from an inherited IRA will equal its starting value (multiplied by 1 minus the tax bracket) regardless of the beneficiary's starting age, the assumed investment rate, and pattern of withdrawals. Matters are different for a CRUT, however, because the tax rate on distributions from a CRUT funded by an IRA should change over time. But for any given constant rate of investment return

[1] I do not address Roth IRAs, spousal rollover IRAs, or IRAs that might pass to minors or young adults.

[2] A CRUT is defined by section 664. A client can create an unfunded and revocable standby trust during life and name it as the beneficiary of the client's IRA or as the contingent beneficiary named after a spouse. At the client's death, the standby trust becomes an irrevocable CRUT, collects the IRA, invests the proceeds, and makes distributions to the individual beneficiary, usually for life. As an unfunded grantor trust, the standby trust has no real tax existence until the client's death. *See* reg. section 1.664-1(a)(4).

[3] I assume that persons in the 25 percent income tax bracket will pay no NII tax.

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and unitrust percentage,[4] there is one unique CRUT distribution stream. Interestingly, this means that for any given age, assuming constant tax federal rates (ordinary, capital, and NII tax), and assuming a constant earnings rate, an inherited IRA and a CRUT will each have one unique present value for their respective after-tax cash flows through the RMD exhaustion date.[5]

Holding these variables identical for a hypothetical inherited IRA and a CRUT that receives the IRA isolates the difference caused by the tax characterization of distributions. One can debate the reasonableness of my set of assumptions, but the conclusions I draw should otherwise apply to the real-world messiness of uncertain investment returns and tax rates.

B. A Baseline Projection

Table 1 compares the present value of after-tax distributions through the RMD distribution date for a CRUT and an IRA under my baseline assumptions. It reflects the distributions from the CRUT only through the RMD exhaustion date, but all inherited IRA distributions are included:

Table 1

Beneficiary Starting Age	Present Value of Inherited IRA	Present Value of CRUT
40	$335,000	$339,730
50	$335,000	$341,876
60	$335,000	$343,396

The key to this difference is that although all distributions from an IRA are taxed as ordinary income, distributions from a CRUT can eventually be taxed at capital gains rates. Under the NII tax rules, income from a CRUT traceable to funds received from an IRA are exempt from the NII tax, and this income thus forms a sublayer of ordinary income for section 664 purposes. Eventually, however, all the IRA income will be fully distributed, and the CRUT beneficiary must pay the NII tax on all further distributions. But because exhaustion of the IRA sublayer is also the point at which a CRUT begins to distribute income taxed at capital gains rates (assuming the CRUT can successfully be invested to avoid income that would refill the ordinary income layer as discussed below), the net shift in tax rates is considerably favorable to the CRUT.

III. Other Potential Advantages of a CRUT

A. Inflation Projection

Although economists hotly debate why this is true, higher rates of inflation generally result in higher nominal rates of equity returns.[6] A 5.5 percent nominal return assumption for a growth-oriented portfolio reflects today's unusually low inflation rate environment. I believe inflation risk should be a factor when considering a decision with a long-term horizon. Table 2 restates the above comparison using an 8.5 percent net investment return:

Table 2

Beneficiary Starting Age	Present Value of Inherited IRA	Present Value of CRUT
40	$335,000	$343,924
50	$335,000	$346,088
60	$335,000	$347,402

B. Longevity Projection

According to the Society of Actuaries, more than half of retirees and pre-retirees underestimate their life expectancy.[7] In fact, a 60-, 50-, and even a 40-year-old annuity beneficiary have about a 1 in 4 chance of surviving to age 94. The beneficiary of a "stretch" inherited IRA will probably live past the RMD exhaustion date and then experience an abrupt and dramatic drop in income. The beneficiary of the CRUT has built-in protection against longevity. On my baseline assumptions, the after-tax value of CRUT distributions from ages 85 through 94 is a nominal $145,493 and $10,235 NPV. Considered as longevity insurance, the CRUT tail has a disproportionate value.

Indicating the value of longevity protection, on July 1, 2014, Treasury promulgated final regulations under section 401(a)(9) that modify the RMD rules to permit an IRA owner to purchase qualifying longevity annuity contracts (QLACs). These contracts are designed to begin distribution after the owner reaches age 85, and they are not included in the IRA's asset base in computing the RMD before then. Inherited IRAs cannot purchase a QLAC.

[4]I ignore potential changes in the section 7520 rate because it has only a minor effect on CRUT valuations.

[5]An inherited IRA must be completely distributed by a date set by the beneficiary's life expectancy at the time of the IRA owner's death.

[6]Geert Bekaert and Eric Engstrom, "Inflation and the Stock Market: Understanding the 'Fed Model,'" 57 *J. Monetary Econ.* 278 (2010); John Y. Campbell and Tuomo Vuolteenaho, "Inflation Illusion and Stock Prices," 94 *Am. Econ. Rev.* 19 (May 2004). *See also* papers collected by the National Bureau of Economic Research, *available at* http://www.nber.org/papers/w15024.

[7]Society of Actuaries press release, "Retirees Underestimate Life Expectancy, Risk Underfunding Retirement" (July 30, 2012), *available at* https://www.soa.org/News-and-Publications/Newsroom/Press-Releases/2012-07-30-retirees-under.aspx.

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C. Other Taxes

1. State taxes. Pennsylvania, for example, taxes distributions from a CRUT but not an inherited IRA.[8] However, it does not tax income in respect of a decedent (IRD), so in NPV terms, most of the CRUT distributions are tax free, and the inheritance tax deduction more than offsets the remaining difference. Because the alternative minimum tax puts a hard floor on the marginal tax rate, for beneficiaries living in states that tax inherited IRAs, a conservative estimate would bring the total state marginal rate to at least 28 percent. Generally, the tables at Section IV.B below suggest that the CRUT will then have the financial advantage.

For owners in states with a so-called death tax, the charitable deduction for only 10 percent of the IRA will not produce major savings. But when the children are younger and in lower-income tax brackets, a state death tax can return the CRUT to parity with the inherited IRA.

2. Federal estate taxes. The funds passing from an IRA after death are IRD. Section 691(c) gives the recipients of the IRD an income tax deduction for the estate tax paid on it. Under my baseline assumptions, that deduction could have a significant value of $66,000 for the inherited IRA, but because the deduction is realized over many years, its NPV is considerably less than the theoretical maximum.

In LTR 199901023, the IRS eliminated nearly all the benefit of the section 691(c) deduction for CRUT beneficiaries by requiring that an amount of IRD received equal to the section 691(c) deduction be treated as corpus; the deduction is not passed through to the beneficiary as with an inherited IRA. As a result, the CRUT beneficiary receives only a minor indirect benefit by accelerating the switch to capital gains distributions. Bottom line: LTR 199901023 created an unfortunate disadvantage to passing to a CRUT an IRA subject to federal estate tax.

Although LTR 199901023 trapped the section 691(c) deduction within the CRUT, the IRS took the opposite position in LTR 9313018.[9] That letter ruling provides that foreign tax payments do pass through to the beneficiary. Without parsing here the specific tax analysis relied on in each letter ruling, I contend that they are inconsistent.

Section 1411(c)(5) provides that distributions from an IRA are not NII. LTR 199901023 in effect transforms 40 percent of an owner's IRA into NII. With due regard for the complexities of mapping general tax rules onto the unique terrain of charitable remainder trusts, I believe LTR 199901023 produces such a discordant result that its highly technical reasoning should now be limited.[10] The ruling not only raises NII tax problems but also nullifies the policy behind the section 691(c) deduction and confounds the general congressional policy to favor charitable giving. Applying the section 691(c) deduction in a parallel fashion to both CRUTs and inherited IRAs is not abusive.

If LTR 199901023 is now obsolete, the federal estate tax deduction for the charitable remainder interest produces a notable additional advantage to the CRUT technique. If the ruling continues to apply, clients with federally taxable estates and minimal charitable interest may want to avoid the CRUT alternative.

D. Spendthrift Protection

The beneficiary of an inherited IRA has complete access to the funds and can withdraw the balance at any time. The advantage of free access should be balanced against the value of protecting funds from creditors,[11] with clients sometimes deciding in favor of creditor protection and against improvident spending. A conduit IRA trust[12] can be used to limit distributions to RMDs, but then any potential cost disadvantage of a CRUT disappears. Although the trustee of a conduit IRA trust can make larger distributions, the value of the ability to occasionally make larger distributions seems doubtful, and true opportunities to wisely spend very large distributions (for example, buying into a business) are rare.

The beneficiary of a CRUT receives more funds earlier than under a stretch IRA but cannot accelerate or defer payments. In the case of severe need, federal tax law provides that a CRUT can be commuted with the consent of the charity and the trustee. The trust corpus is divided between the individual beneficiary and the charitable beneficiary on an actuarial basis. Under section 1001(e), the individual beneficiary pays capital gains tax on

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[8]A state-by-state analysis is beyond the scope of this report.

[9]Because foreign tax payment information from investments cannot be predicted in advance, LTR 9313018 makes it impossible for a charitable remainder trust to timely determine how much to distribute. The over- or underpayment for one year affects a CRUT's valuation for the next year, meaning the problem compounds itself. The ruling creates a significant amount of administrative complexity for no clear policy purpose.

[10]LTR 199901023 has never been cited.

[11]The Supreme Court has held that an inherited IRA is available to satisfy the claims of creditors in bankruptcy. *Clark v. Rameker*, 134 S. Ct. 2242 (2014). In contrast, distributions from a CRUT with a spendthrift clause are generally beyond the reach of creditors in bankruptcy.

[12]*See* reg. section 1.401(a)(9)-5, Q&A 7, Example 2.

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the entire commuted proceeds, so the decision to commute should not be made lightly.

E. Involving Heirs With Charitable Giving

Parents can choose to let children control some or all of the charitable remainder interest. Parents can also give children the discretion to appoint a percentage of the annual distribution to a charity,[13] although this does not increase the charitable deduction. But if a child uses this provision in lieu of his own charitable gifts, the effect is equivalent to a perfect deduction — the NII tax and the Pease limitation are avoided, and the income does not add to the child's adjusted gross income for other limitation purposes.

IV. Assessing Potential Objections to the Model

A. Lower Beneficiary Tax Brackets

The NPV results above are not as sensitive to tax rates as one might expect. Table 1 is reproduced below assuming that the ordinary income tax rate is 28 percent. If a meaningful portion of the CRUT distributions are below the NII tax exemption,[14] the disadvantage disappears:

Table 3

Beneficiary Starting Age	Present Value of Inherited IRA	Present Value of CRUT
40	$360,000	$356,314
50	$360,000	$359,842
60	$360,000	$362,958

Table 4 is using a 25 percent ordinary income tax rate, with the CRUT beneficiary's modified AGI assumed to fall below the NII tax exemption:

Table 4

Beneficiary Starting Age	Present Value of Inherited IRA	Present Value of CRUT
40	$375,000	$371,763
50	$375,000	$375,354
60	$375,000	$378,498

Although any prediction about future tax policy is uncertain, a continued capital gains rate seems a reasonable assumption. Under current law, the 20 percent capital gains rate applies only when ordinary income is taxed at the highest bracket, and higher tax rates strongly favor the CRUT.

B. The Cost of Avoiding Ordinary Income

With immaterial exceptions, an IRA and a CRUT are identical tax-exempt investment environments internally. Other things being equal, the total return available under each strategy should be equal. However, the best use of a CRUT as an IRA distribution vehicle requires an investment strategy focused on avoiding ordinary income. While the point is debatable, there are three reasons to think that avoiding ordinary income in a CRUT does not create a comparative disadvantage.

First, a CRUT is rarely the beneficiary's only investment asset. The beneficiary's total investment strategy can overweight bonds in other vehicles to obtain the desired aggregate risk-return profile. Overweighting equity in a CRUT should be desirable because a CRUT can sell assets without tax cost, unlike equity assets in a taxable environment.

Second, risk tolerance is in part a psychological function. An investor with a taxable portfolio experiences market declines as a direct reduction of personal net worth. The CRUT beneficiary experiences declines only as a reduction in next year's distribution. The portfolio loss is shared with the charitable remainder beneficiary, which over time increasingly bears the burden. Further, investment professionals generally counsel accepting greater risk as the investment horizon lengthens — and a CRUT has a lifetime design. Over the long run, portfolios weighted toward appreciation tend to outperform more balanced portfolios.

Third, to some degree, municipal bonds[15] and high-dividend stocks such as utilities can act as stand-ins for taxable bonds.[16] I modeled a CRUT portfolio composed of equities, utilities, municipal bonds, and taxable bonds, annually rebalanced. I weighted equities producing 7 percent appreciation and 1 percent dividend yield at 70 percent. I weighted each of the other three classes producing a 3 percent current yield at 10 percent. With expenses at 1 percent, the net constant return is a nominal 5.5 percent, identical to the baseline assumption. Table 5 shows the present value result with this portfolio through the RMD exhaustion date when ordinary income is taxed at 33 percent:

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[13]As long as the charitable income interest is irrevocable, section 674(b)(4) prevents the grantor trust rules from applying to the gifted income amount. *See also* LTR 200029033.

[14]I note that the logic of *Clark*, 134 S. Ct. 2242, could lead to a change in section 1411. If inherited IRAs become subject to the NII tax, the CRUTs tax savings advantage becomes even larger.

[15]Although the point cannot be addressed here, I do not believe that investment in municipal bonds is per se a violation of section 4941.

[16]Because the return from municipal bonds falls into a layer lower than capital gain income, it has the effect of pushing out capital gain and adds a way to provide a fixed yield component without disturbing the objective of capital gain income only.

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Table 5		
Beneficiary Starting Age	Present Value of Inherited IRA	Present Value of CRUT
40	$335,000	$337,364
50	$335,000	$340,092
60	$335,000	$342,147

C. The Cost of CRUT Administration

Investment advice is by far the largest cost component of administering the typical trust. Corporate trustees often bundle fiduciary services with the cost of investment advice. Assuming professional investment advice is needed, it is unclear that above specified minimums, CRUTs using a corporate fiduciary have meaningfully higher costs than inherited IRAs. Individual IRAs often pay retail rates for investment advice, while trusts with a corporate fiduciary benefit from the bank's institutional funds structure, which helps offset the cost. CRUT administrative expenses can become an invisible part of the investment advice[17] if the family has a larger relationship with the corporate fiduciary. Table 6 tests the case in which the administration-investment fee of a CRUT is 1.25 percent and the same fee for an inherited IRA is 1 percent:

Table 6		
Beneficiary Starting Age	Present Value of Inherited IRA	Present Value of CRUT
40	$335,000	$328,731
50	$335,000	$333,501
60	$335,000	$337,616

D. The Mortality Risk

1. Adjusting the apparent size of the problem. Isn't the potential mortality cost of a CRUT equal to the 10 percent value of the charitable remainder interest? Before considering this question in its proper context as an estate planning issue, I must correct the apparent size of the problem.

The 10 percent remainder requirement for CRUTs is computed using an actuarial table that is based on whole population data. Clients introduce a selection bias by avoiding CRUTs for children with health issues, so it is appropriate to use annuitant mortality tables. If the remainder interests in the CRUTs described above are calculated using the IRS's method but with Annuity 2000 tables,[18] the computed values are significantly smaller[19]:

Table 7		
Beneficiary Starting Age	Male Charitable Remainder	Female Charitable Remainder
40	7.63%	5.64%
50	7.51%	5.2%
60	7.1%	4.79%

Table 7 is based on the beneficiary's entire life expectancy. But in comparing distribution streams through the RMD date, the mortality risk to a CRUT for periods after that date should be disregarded. Table 8 shows that adjustment:

Table 8		
Beneficiary Starting Age	Male Charitable Remainder	Female Charitable Remainder
40	6.75%	4.45%
50	6.84%	4.29%
60	6.54%	4.23%

One further adjustment is helpful. The CRUT method produces the relative *pretax* values of the life interest and the remainder interest. A dying beneficiary loses only the after-tax value of unreceived CRUT distributions. One can conceptualize the amount "lost" to charity as its net after-tax value to the beneficiary. From this perspective, for a beneficiary in the 33 percent income tax bracket, Table 8 can be recast as Table 9. As should be apparent, the size of the mortality risk problem — using the IRS CRUT valuation method but assuming a healthy taxpaying beneficiary — is considerably less than it appears at first glance:

Table 9		
Beneficiary Starting Age	Male Charitable Remainder	Female Charitable Remainder
40	4.52%	2.98%
50	4.58%	2.87%
60	4.38%	2.83%

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[17]Aggregating the assets of a charitable remainder trust with other assets to reduce the investment charges on other accounts probably violates section 4941. However, it is entirely permissible to provide that the fee discount from aggregation be allocated exclusively to the CRUT.

[18]*See* Robert J. Johansen, "Annuity 2000 Mortality Tables," Transactions of Society of Actuaries 1995-96, 47 *Reports* 266.

[19]A word of caution is necessary. The IRS method for computing the value of the charitable remainder interest in a CRUT is independent of earning assumptions and tax rates. Accordingly, the information in the following three tables cannot be directly applied to my NPV analysis.

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2. The intergenerational trade-off. Still, the mortality risk is not trivial. But actuarial principles do not translate directly to the case of a single family, which creates the hardest education problem for clients. The male annuitant life expectancy is slightly longer than the RMD exhaustion date.[20] Any one beneficiary will either die prematurely or not. Thus, as a single probabilistic question for that beneficiary, the predicted mortality cost of a CRUT is zero; by the RMD exhaustion date, the beneficiary will have received roughly as much as the inherited IRA beneficiary.

If a premature death is assumed, the probability of a large loss is quite small. Table 10 assumes a male beneficiary using the baseline assumptions. The third column states the ratio of (1) the net present after-tax values of CRUT distributions for the given survival period to (2) those values from start through the respective RMD period:

Table 10		
Male Beneficiary With Starting Age of 50		
Survival Period	**Cumulative Probability of Death**	**Percentage of NPV Received**
3 years	0.98%	27.7%
5 years	1.78%	44.3%
7 years	2.7%	59.4%
10 years	4.33%	79.7%
Male Beneficiary With Starting Age of 60		
Survival Period	**Cumulative Probability of Death**	**Percentage of NPV Received**
3 years	1.44%	40.4%
5 years	3.13%	61.2%
7 years	5.15%	78.1%
10 years	9%	98.1%

The foregoing table blurs the mismatch between the benefits and the loss. The named beneficiary will probably receive more after tax from a CRUT than from an inherited IRA and will also enjoy the additional economic and noneconomic benefits. If a premature death does occur, however, the loss will fall on a younger generation. Advisers should recognize this issue as the classic tension between life tenants and remainder beneficiaries: What is given to the life tenant must be withheld from the remainder beneficiary. The benefits of a CRUT can be obtained for children only by accepting the tiny risk of loss to the younger generation. Moreover, from a holistic estate planning perspective, there is no loss. What does not pass to the children after tax passes instead to the charity pretax. The comprehensive picture of the mortality risk, then, is composed of three observations: The child will most likely survive to or beyond the RMD exhaustion date; the cost of a premature death to the grandchildren is unlikely to be large; and any loss to the grandchildren simply represents a desired benefit to charity.

3. Hedging the risk. Low-probability but significantly adverse outcomes are preferably handled by insurance. Although obvious in a sense, clients must concentrate on the critical fact that the mortality risk here is that of the child, not the client. The factors affecting the need, cost, availability, and alternatives to life insurance are bewildering and are best left to the insured. Perhaps the child has a large policy in place as part of a cross-purchase agreement, or the child's spouse has received a large inheritance. Perhaps the child's assessment of his own children's best interests is different from the client's assessment (and it is rarely wise for the older generation to interfere with *that* judgment). Although there is some correlation between receiving a life estate and the need for more insurance, that correlation is nearly invisible among the other relevant considerations.

If the child is already sufficiently insured against the risk of premature death, increasing the probability of sunk costs[21] by analyzing the CRUT as if paired with a declining benefit term life insurance policy serves no meaningful estate planning purpose. For the dependents of sufficiently insured children, the possibility of loss from the CRUT is matched by the possibility of a windfall from insurance. Relying on one's children to provide for one's grandchildren is usually the wisest choice.

Insurance is not the only hedging alternative available. A two-life CRUT for individuals ages 60 and 30 narrowly meets the 10 percent charitable remainder requirement. If an independent trustee is used, a ''sprinkle'' CRUT can give an independent trustee the power to divide distributions between the child and the grandchild. The grandchild likely has the greater life cycle need for additional income and may be in a lower tax bracket. The sprinkle feature can be attractive for some clients and definitely reduces the mortality risk.

E. The 'Dying With the Most Toys' Objective

My NPV analysis admittedly ignores the post-distribution use of funds by giving equal value to

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[20]The RMD life expectancy for a 40-year-old is 83.6, while the Annuity 2000 tables provide a 51.41 percent probability that a male will reach 84. If historical trends continued, one would expect even longer annuity life expectancies today.

[21]Even with a 60-year-old male beneficiary, the starting annuity mortality risk is less than 1 percent per annum, so the life insurance mortality charges (which are calculated with an opposite selection bias) are virtually certain to be dead losses for many years.

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all distributions whether consumed or reinvested. This approach is inadequate if one prioritizes the accumulation of wealth over enjoyment. The beneficiary of an inherited IRA, but not a CRUT, can "invest" in it by limiting the size of distributions. That IRA "investment" enjoys the continued benefit of a tax-exempt environment. The value of this benefit may not be as large as one imagines because this question intersects with the special class of cases in which the time value of money principle does not apply.

Suppose that for some given year the CRUT beneficiary in the 33 percent bracket must withdraw $10,000 more than the beneficiary of a stretch IRA. The CRUT beneficiary pays $3,300 in tax and reinvests $6,700, while the stretch IRA beneficiary keeps the $10,000 invested in the IRA. Assume the CRUT beneficiary invests in undeveloped land held until death that appreciates at the same rate of return earned by the IRA assets. At some point the RMD requirements force the distribution of the retained funds from the stretch IRA. For convenience, assume that during this period the assets have doubled.[22] The land will be worth $13,400. The IRA beneficiary will receive $20,000, pay tax at 33 percent in the amount of $6,600, and have $13,400. If the land is held until death and a step-up in basis is gained, there will never be a disadvantage to having paid tax early.

Although portfolios typically are intentionally tax-managed to reduce the annualized capital gains rate, a zero turnover rate over decades is unrealistic. The stretch IRA admittedly shines for beneficiaries with a laser focus on wealth accumulation. I have constructed a comparison assuming that in both cases the beneficiary invests after-tax distributions in an outside portfolio with the characteristics described in the text accompanying note 15. In that outside portfolio, I model a 5 percent annual turnover rate, recognizing average built-in appreciation for each year as an approximation of tight tax management (as shown in table 11):

Table 11. Dying With the Most Toys Advantage of a Stretch IRA

Beneficiary Starting Age	NPV Value to Total Accumulation Behavior
40	$11,383
50	$21,218
60	$46,532

But the tax-exempt and taxable investment environments are not the same. Leverage is one of the most powerful investment tools. An IRA cannot have a margin account.[23] Passthrough investments that produce unrelated business taxable income are doubly taxed in IRAs, first as UBTI and again when the distribution is made. A large portion of the alternative investment space is occupied by vehicles that generate UBIT, and IRA investments in closely held entities rarely pass muster under section 4975. Suppose we assume that the ability to make alternative investments and use leverage increases the total return for the taxable portfolio to 6.5 percent. Table 12 restates Table 11 on those terms:

Table 12. Dying With the Most Toys Advantage of a Stretch IRA

Beneficiary Starting Age	NPV Comparative Value of a Total Accumulation Strategy
40	-$12,223
50	$4,134
60	$33,611

A stretch inherited IRA bunches about half of the total lifetime distributions into the last 10 years — roughly from age 75 to 85. Although I have not tried to model the effects of income tax bracket shifts and AGI-derived haircuts and phaseouts, those seem both guaranteed and significant. Distributions from a CRUT are spread out earlier and over more years, and simply do not have the same bunching problem.

In practice, few clients and even fewer beneficiaries are interested in spending nothing. Even if wealth preservation and transmission are high priorities for clients, both those objectives require a consideration of how future generations will deal with wealth. I suggest to clients and their children that teaching grandchildren how to handle wealth works best when funds are passed downstream at earlier ages as opposed to exclusively accumulating wealth during the child's life. This factor favors a CRUT.

V. Communicating With Charts

Given the vast sums spent advertising the advantages of IRAs, it is no wonder that clients start with a bias against alternatives. The following charts may help communicate the points made above for clients with some interest in charity and a willingness to learn.

Using my baseline assumptions on a pretax basis, Figure 1 illustrates the reasoning that dismisses the use of a CRUT in IRA planning. The huge bulge of stretch IRA distributions late in life is visually

[22]My conclusion holds for any amounts of equal total return.

[23]Section 408(e)(4).

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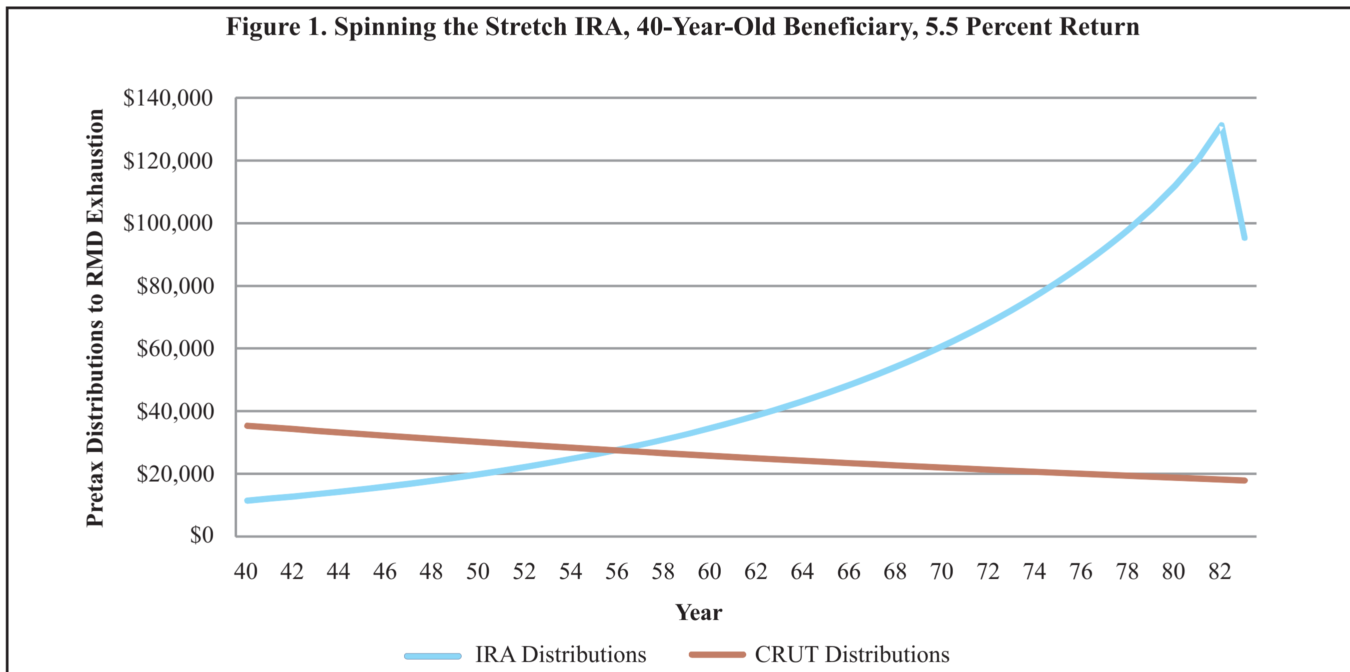

arresting. The spin of presentations similar to Figure 1 is that the stretch IRA is a fabulous tool.

By sight alone, one cannot compare across decades the much larger, later RMD distributions to the somewhat larger, earlier CRUT distributions. Unfortunately, in my experience, clients find constant dollar charts very confusing. One way to present a reasonable nominal dollar comparison is to illustrate the result if the beneficiary of the inherited IRA annually withdraws enough each year to match, after tax, the net after-tax amount received by the CRUT beneficiary. Figure 2 restates Figure 1 with this assumption so that a client can visually verify that if continued through the RMD exhaustion date, the after-tax distributions from the CRUT are essentially equal to, and actually exceed, the distributions from an inherited IRA. The odd bump upward around age 50 is caused by the switch from ordinary income to capital gains income from the CRUT. Figure 3 restates Figure 2 with an 8.5 percent fixed return. The left vertical black line is the life expectancy of a male, while the right vertical line is the life expectancy of a female.

VI. Conclusion

Realistically, clients who rarely give to charity are unlikely to be interested in the CRUT alternative. But according to the National Philanthropic Trust, more than 98.4 percent of high-net-worth households give to charity.[24] There is every reason to think that most clients will be willing to at least hear about a charitable gift that likely costs their family little or nothing. Moreover, the putative advantage of a rigorously stretched inherited IRA requires spending choices for beneficiaries that are simply bizarre from a more holistic perspective.

(Figures 2 and 3 appear on the following page.)

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[24]Data obtained from National Philanthropic Trust, "Charitable Giving Statistics," *available at* http://www.nptrust.org/philanthropic-resources/charitable-giving-statistics. This report was based on "The 2014 Bank of America Study of High Net Worth Philanthropy" (Nov. 2012), which considered only households with incomes exceeding $200,000 or net worth of more than $1 million, excluding the monetary value of their home.

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Figure 2. A Fairer Comparison, 40-Year-Old Beneficiary, 33 Percent Bracket, 5.5 Percent Return

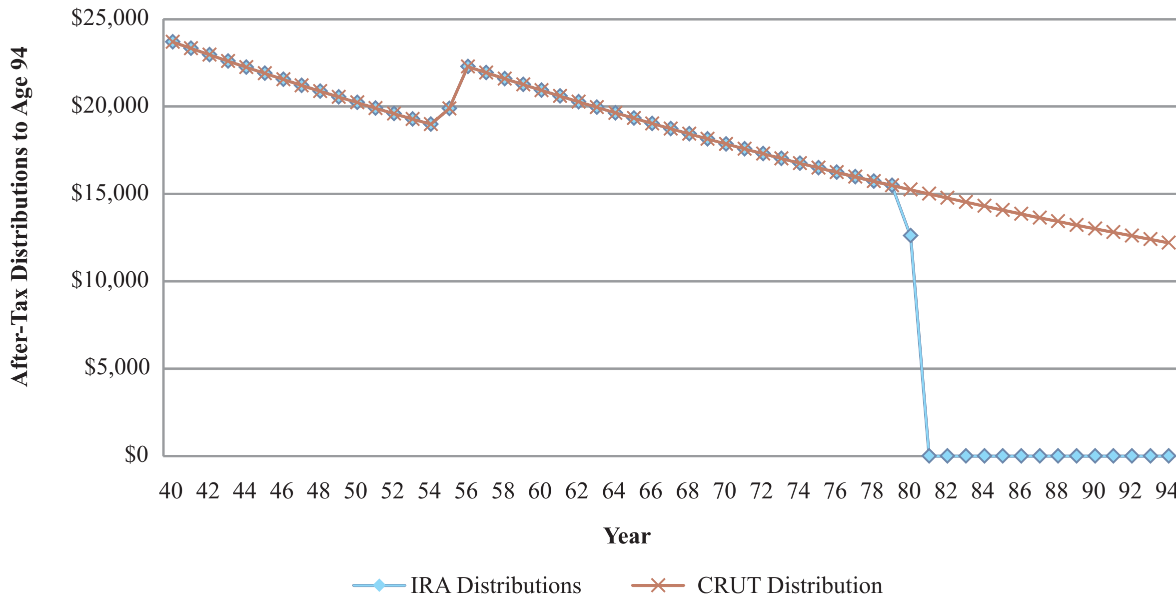
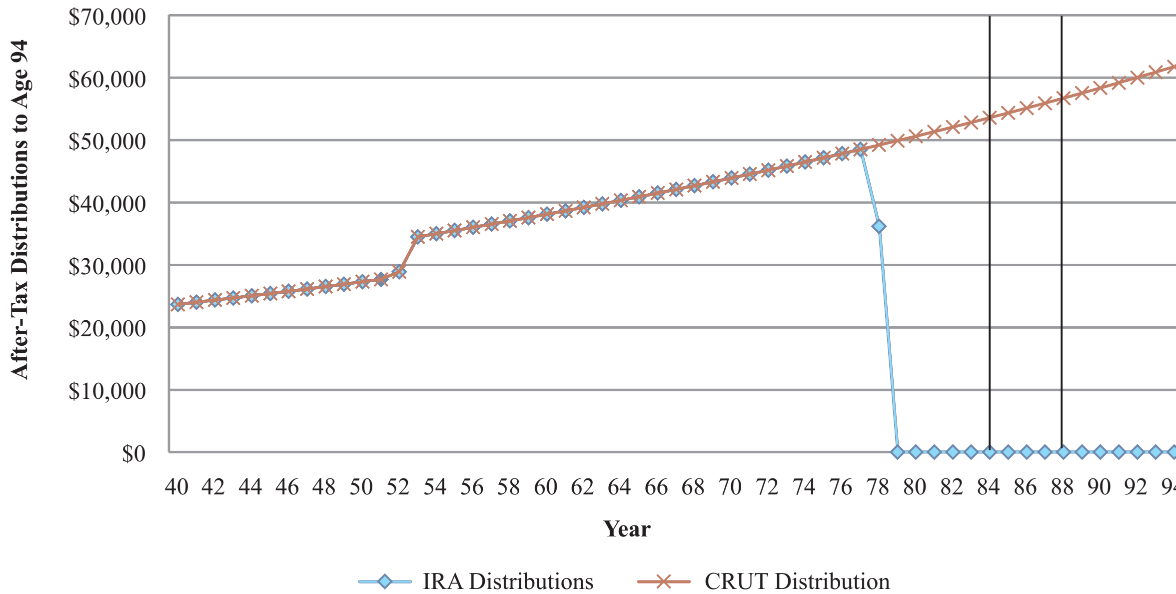


Figure 3. Inflation Comparison, 40-Year-Old Beneficiary, 33 Percent Bracket, 8.5 Percent Net Return



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