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Charitable IRA: Good Strategy or Shell Game?

Practitioners are often confronted with philanthropic clients who are interested in benefiting charities during their lifetime, yet lack the financial resources to make large inter vivos gifts. As assets held in IRA's continue to become a larger percentage of our clients net worth, understanding the Charitable IRA strategy may be time well spent.



Walter Moore, CFP
Vice President

The basic idea of the Charitable IRA (dubbed CHIRA®) is that the donor lends cash from his IRA to his designated charity in return for an interest bearing note. To secure the note, the charity uses a portion of the loan proceeds to purchase a contractually guaranteed life insurance policy on the donor and collaterally assigns the death benefit to the IRA. The remaining proceeds of the loan can be used immediately by the charity. There is no tax deductible gift by the donor or any taxable distribution from the IRA. In July of 2007, the IRS published Ltr. Rul. 200741016 that concludes the strategy is not a prohibited investment in insurance nor would it cause the disqualification of the IRA. In order to more closely examine the benefits of the strategy, let's walk through a hypothetical case study:

Our Client / Donor is age 72, has a life expectancy of age 88, medically qualifies as a "standard" rating with an insurance carrier, owns an IRA worth \$2 million today and is willing to use half the value to benefit a charity for an important project, but would like to maintain the \$1 million principal value for his grandkids. Our client is also willing to gift annually (as he has for years) to the charity.

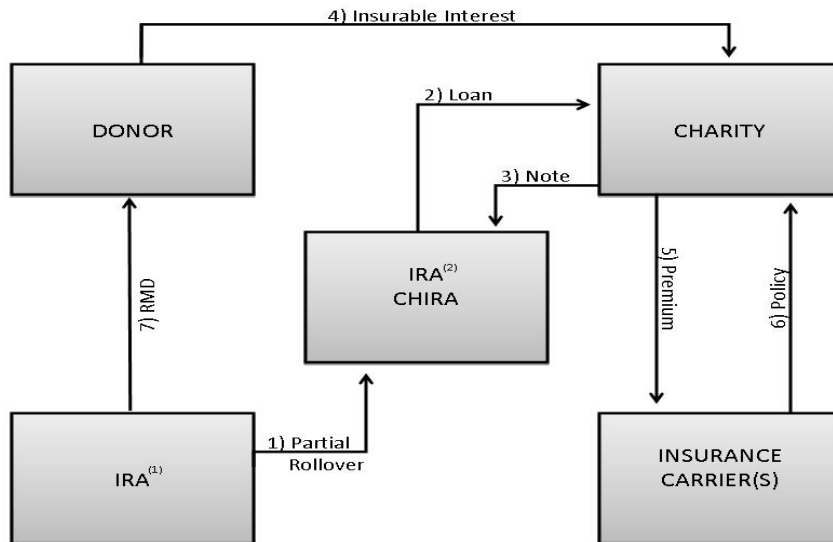
Half the current IRA value (\$1 million) would be transferred to a separate IRA custodian willing to be part of the transaction. Any required minimum distributions would be assessed from the original IRA. The \$1 million loan is transferred to the charity and a 5% interest only twenty-year note (interest rate must be prevailing and reasonable) is taken back in return. The charity, already having completed the underwriting on the donor, uses \$505,000 to purchase a universal life insurance policy with a rider that contractually guarantees the death benefit for the donor's life. This conservative funding strategy eliminates the variability of future policy performance and reduces the risk to the charity to the credit quality of the chosen carrier. In other words, the death benefit will be paid regardless as long as the carrier remains solvent. The policy contains a collateral assignment of the \$1 million death benefit in favor of the IRA to secure the note. The charity is the owner, premium payer, and beneficiary on the policy.

The CHIRA® program (patent pending) and trademark are the intellectual property of CHIRA® USA, LLC. Refer to www.CHIRAU.SA for more information.





CHIRA® Transaction Flowchart



The charity now enjoys \$495,000 of unrestricted funds. Of course, the note requires annual interest payments of \$50,000, which we are assuming the donor to make annual (tax deductible) cash gifts in an equal amount. If the donor would not wish to make these future gifts, the charity would need to hold back an interest reserve from the loan proceeds and ultimately use other resources in the future assuming the donor lives to (or beyond) life expectancy. Either way, the interest payment to the IRA must be made annually.

Do any of the parties benefit from this transaction or is it simply moving money around in a complicated shell game? Imagine you are a charity and a single donor makes annual cash gifts that equal a significant portion of your annual budget. If that donor were to die (without doing planned gifts) it would significantly impact your operation. However, by being party to the CHIRA®, the charity captures a significant sum today and gives up use of the annual cash gifts (used to pay the interest on the note) during the remainder of the donor's life. In our example, the net proceeds of \$495,000 invested at 5% would provide \$50,000 annual withdrawals for 14 years (or our donors age 86). Therefore, the charity accepts the small risk of the insurance carrier becoming insolvent and unable to pay the death benefit and receives 14 years of annual gifts today. If the donor lives beyond year 14, the annual gifts would have a higher present value than \$495,000, and therefore the transaction becomes less financially viable as the donor lives beyond his life expectancy. However, attaching "life expectancy" to a single life has virtually no statistical meaning whatsoever. The charity eliminates the risk of the donor dying prematurely (or changing his mind on making annual gifts) and accepts the risk that the proceeds today outweigh the donor's future annual gifts over his lifetime.



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Now let's review the bottom line for our donor. Under the assumption that the donor is already gifting annually, they may be frustrated that they can not help fund a major project today and also meet their estate planning goals. By unlocking the value of the IRA, the donor can shift a significant sum to the charity today and enjoy being part of the major project. The donor, depending on his remaining financial assets, may give up some potential return by accepting the note interest rate on his IRA versus what he could make in other investments. He also is gifting the value of his insurable interest. This likely would not have an impact, but insurance companies (and reinsurers) do have per life limits that could affect other planning with insurance the client would like to pursue.

While not a panacea of charitable planning, with the right set of circumstances the CHIRA® deserves a look as one of many charitable planning strategies.

If you have any questions, please do not hesitate to call us at 440-740-0130.

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