How Charities May Collect IRA Beneficiary Designations

Traditional IRAs are funded with pretax dollars and grow tax free. Many traditional IRAs are created through rollovers of other types of qualified plans at retirement. The Investment Company Institute (ICI) estimated in November 2018 that total retirement assets were $28.3 trillion and IRA balances were $9.26 trillion.

Many loyal donors designate a charity to receive part or all of an IRA. With the rapid growth in the number of IRA designations to charities, many nonprofits have encountered problems with the transfer from custodians to charities upon demise of the IRA owner. Some IRA custodians may require the charity to create an IRA account, claim that the charity is subject to provisions of the Patriot Act or decide to withhold 10% of the IRA to pay income tax. Charities and their counsel must understand the correct responses to these claims in order to expedite the receipt of IRA proceeds.

Problem: The IRA custodian claims that the charity must set up a new account.

Response: The charity is not an individual and therefore not qualified to set up an IRA account. Under Reg. 1.408-2(b), an IRA account must be for "the exclusive benefit of an individual or his beneficiaries." A charity is a corporation and defined as a "person" under the IRC, but a nonprofit corporation is clearly not an individual. Therefore, the charity is not qualified to set up an account. The appropriate response for the custodian is to transfer the designated amount directly to the charity.

Problem: The custodian attempts to apply the Patriot Act or FINRA Rule 2090 (Know Your Customer) to the charity. Some IRA custodians ask for detailed personal and financial information of nonprofit board members.

Response: The USA Patriot Act was passed in 2001 for the purpose of protecting America and reducing the risk that funds would be transferred overseas. Sec. 326 of the Patriot Act provides that "financial institutions" shall be required to exercise efforts to reduce the risk of funds being used by suspected terrorists or terrorist organizations. Patriot Act Sec. 326 applies if an individual or corporation attempts to open a bank account. The bank must maintain records to verify the person's identity, name, address and other identifying information and ascertain whether or not the person is on the list of known or suspected terrorists.

The Patriot Act and FINRA Rule 2090 (Know Your Customer) do not apply to U.S. nonprofits if they are not creating a bank or IRA account. See Patriot Act Sec. 326. In addition, our U.S. nonprofit is not on the known or suspected terrorist list. Therefore, there is no application of the Patriot Act or FINRA Rule 2090 to the distribution of an IRA balance to a U.S. nonprofit that is not setting up a bank or IRA account.

Problem: The IRA custodian may withhold 10% of the distribution and send it to the IRS.

Response: U.S. nonprofits are tax exempt. While there is generally a requirement to withhold tax on IRA distributions to individuals, it is possible to elect no tax withholding

on IRS Form W-4P. In any case, a qualified exempt charity is not subject to income tax and there is no requirement for withholding.

Letter to General Counsel to Facilitate IRA Collection

Some IRA custodians may create roadblocks to delay distributions to nonprofits. In order for a nonprofit to collect its share of an IRA, it may be necessary to send a letter to the general counsel of the bank or other financial custodian. Click here for two specimen letters.

The first letter is sent to IRA custodians who require the nonprofit to create an inherited IRA account. However, some enlightened IRA custodians do not require the nonprofit to set up an inherited IRA account and the second letter may be used. Nonprofits are granted permission to use these letters with the nonprofit's name, address and specific goals. The donor's name and account number also must be updated.