

IRA Collection and 401(k) Bequests to Charity

By Charles Schultz

December 1, 2023

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 will promptly distribute the funds to a nonprofit, but others may delay or create roadblocks to that distribution. 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. Below are two specimen letters that nonprofits may modify and send to the general counsel of the IRA custodian. 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 must also be updated.

Iowa attorney Johni Hays and the National Association of Charitable Gift Planners are collaborating and publish a list of the "enlightened" IRA custodians on www.charitablegiftplanners.org/rift-database-ira-custodians.

Specimen Letter if IRA Custodian Requires Nonprofit IRA Account

January 1, 2025
Mr. or Ms. General Counsel
IRA Custodian
1234 Michigan Avenue
Chicago, IL 00000

Dear General Counsel:

We have been informed that Favorite Charity is a beneficiary of the IRA of Jane Doe. The IRA account number is 123-45-678. We request that you liquidate the IRA funds held for our benefit and send a check to us within 30 days at our address: Favorite Charity, Bequest Administrator, [123 Oak Street, Chicago, IL 00000](#).

Favorite Charity is not required to open an IRA account with a custodian to receive an IRA distribution. Under Reg. 1.408-2(b), an IRA account must be created "for the exclusive benefit of an individual or his beneficiaries." A charity is a nonprofit corporation defined as a "Person" under the IRC, but a charity clearly is not an individual and therefore not permitted to set up a Sec. 408 IRA account. In addition, as custodian you are trustee of an IRA trust under Reg. 1.408-2(b). You are required by federal and state law to comply with the fiduciary responsibilities of a trustee. If you fail to make the distribution as required in your contract with the IRA owner, you are potentially in breach of your duty of fiduciary responsibility.

Favorite Charity is not subject to the USA Patriot Act (Pub. L. 107-56) or FINRA Rule 2090. Sec. 326 of the USA Patriot Act requires banks and other custodians to determine that a person opening an account is not on the suspected terrorist list. First, IRC Sec. 408 does not permit a nonprofit to open an IRA account. Because the charity cannot open an IRA account, both the Patriot Act and FINRA Rule 2090 do not apply to an IRA distribution to charity. In addition, we are a U.S. recognized exempt charity and not on a suspected terrorist list.

Finally, IRA custodians may withhold 10% of a distribution to individuals and remit that amount to the Internal Revenue Service. We are tax exempt and elect under IRS Form W-4R to not have tax withheld. Because we are tax exempt, there is no requirement for withholding on your part. Enclosed is a copy of our IRS tax exemption letter. Our IRS identification number usable on Form 1099-R is 00-1234567. There is no IRS requirement to have an IRA account for you to issue Form 1099-R. If we are a partial beneficiary of the IRA, we waive and release all rights to divided future interests or odd shares earned after the date of death and request prompt distribution of our IRA proceeds prior to completion of actions by other beneficiaries.

Because we are not permitted to open an IRA account, the USA Patriot Act and FINRA Rule 2090 do not apply to a U.S. charity not opening an IRA account and withholding is not required, we request that you remit within 30 days the full distribution to the above address. If you are unable to distribute our vested IRA funds within 30 days, then, in a manner similar to Sec. 6662(a), we should receive the IRA funds and a 20% penalty amount. Because after the 30-day period you are in breach of contract and breach of trustee fiduciary responsibility due to noncompliance with terms of the IRA agreement, we will be willing to settle for the IRA funds plus a 20% penalty.

If you feel you are unable to make this prompt distribution as requested, please have your Legal or Compliance Department provide a written explanation of your legal basis for not distributing these IRA funds to us. Reminder -- this is a trust. You are subject to a breach of fiduciary responsibility claim for failure to follow trust terms.

Sincerely,

Susan Officer
Vice President, Favorite Charity

Specimen Letter if IRA Custodian Does Not Require Nonprofit IRA Account

January 1, 2025

Favorite Charity
123 Oak Street
Chicago, IL 00000

Dear General Counsel:

We have been informed that Favorite Charity is a beneficiary of the IRA of Jane Doe. Your financial institution serves as the IRA custodian. Under Reg. 1.408-2(b), an IRA account must be created "for the exclusive benefit of an individual or his beneficiaries." A charity is a nonprofit corporation and is defined as a "Person" under the IRC, but a charity clearly is not an individual and therefore not permitted to set up a Sec. 408 IRA account. Therefore, we appreciate your organization's decision that our charitable organization will receive our share of the deceased's IRA without the need to open an Inherited IRA.

The IRA account number is 123-45-678. We request that you liquidate the funds held for our benefit in the trust account and deliver them by check within 30 days to our organization at this address: Favorite Charity, Bequest Administrator, [123 Oak Street, Chicago, IL 00000](#).

While IRA custodians often withhold tax on a distribution to individuals, as a nonprofit we are tax exempt and elect under IRS Form W-4R to not have tax withheld. Because we are tax exempt, there is no income tax on our IRA distribution and no requirement for withholding on your part. Enclosed is a copy of our IRS tax exemption letter. Our IRS identification number is 00-1234567. If you are not able to issue a computer-generated IRS Form 1099, we will accept one that is a manually produced. If we are a partial beneficiary of the IRA, we waive and release all rights to divided future interests or odd shares earned after the date of death and request prompt distribution of our IRA proceeds prior to completion of actions by other beneficiaries.

If you feel you are unable to make this prompt distribution as requested, please have your Legal or Compliance Department provide us with your legal basis for holding these funds and not distributing them to us. We remind you that this is a trust and you are potentially subject to a breach of fiduciary responsibility claim if you do not comply with the terms of the IRA agreement.

Sincerely,

Susan Officer
Vice President, Favorite Charity

Iowa attorney Johni Hays and the National Association of Charitable Gift Planners are collaborating and publish a list of the "enlightened" IRA custodians on www.charitablegiftplanners.org/rift-database-ira-custodians.