



## Giving Retirement Assets To Charity Can Make Sense

For most people, retirement assets have become a significant part of their estate. Because of the uncertainty regarding social security and inflation, retirement plans have gained in importance as a primary resource of income during the retirement years.

Most retirement plans in the past were pension plans which produced a stream of income similar to social security for the employee and his or her spouse at retirement and continued until the death of both. Pension plans could not be given to heirs, and they were viewed strictly as a lifetime resource available to the retiree and the spouse. During the last ten years, most retirement plans have changed to allow for lump sum distributions as well as lifetime payments. These retirement plans are part of your estate and can be given to family or charity at death. Most people, however, continue to consider their retirement plan asset as a resource to provide income during retirement, which must last until their death, as opposed to an asset which can be used to pay for things during life.

Because these assets are viewed as resources, people choose to adjust their lifestyles based on the income production of their retirement plans. In essence, many years of eggs versus one chicken dinner. This development has made investment advisement for these assets during retirement a critical concern. Because any retirement plan's main purpose is to provide for people in retirement, many do not think of it as an asset which will be passed on to their family -- making it a good consideration for charitable giving, especially when the potential tax consequences are considered.

### Taxes And Retirement Plans

There are probably no more highly regulated entities under the IRS code than the qualified retirement plans. Retirement plans can be structured as corporate plans, IRAs, KEOGHs, 403(b) plans or 401(k) arrangements. Plan assets are potentially subject to at least three types of taxes:

1. The 10% penalty tax for distributions before age 59 ½ under IRC 72(t).
2. The income taxes during life (IRC 61(a)) or at death (IRC 691(a)), which are due when assets are taken out of the plan.



3. Estate tax under IRC 691(a) which can range from 30% to 48%, depending on the size of the estate.

Generation Skipping tax can occur when retirement assets go directly to grandchildren or great-grandchildren. Though there is an exemption, the rate is 48% after that (IRC 2601).

The exemption amount for both the Estate Tax and the Generation Skipping tax will drop back down to one million dollars in 2011.

The 10% penalty tax is easily avoided by waiting until age 59 ½ to withdraw money, and estate tax and generation skipping tax are often handled with normal estate planning, but the income tax consequences will affect almost everyone.

### Income In Respect Of A Decedent

The proceeds of IRAs and qualified retirement plan accounts after death are taxable in most instances for income tax purposes to the estate or to the direct recipient of the plan assets in the year received. This additional income is called Income in Respect of a Decedent (IRD). This income is normally taxed at the top tax rates because the total is added to your heirs income in the year received -- usually driving them into the top tax bracket for some or all of the proceeds. This income is subject to both federal and state income taxes, leaving the recipient often with less than two-thirds of the value of the assets. For example, if an individual had a retirement plan of \$2,000,000 at death, over \$650,000 could be due in income taxes. Given such erosion in value, it's no wonder that increased attention has been paid to combining charitable gift planning with retirement plan distributions.

### Outright Gift Or Bequest To Charity

If an individual wants to make a charitable gift from their estate, a distribution directly from their retirement plan or IRA to charity avoids the IRD tax. Making a distribution from the plan to charity, as opposed to making it as a bequest under a will, could save a significant amount in taxes. For example, if an estate consists of a house worth \$250,000, a life insurance policy of \$500,000, and retirement assets of \$500,000, the value of the estate would be \$1,250,000. If the individual intends to give 20% of his or her estate, or \$250,000 to charity at death, there would be no estate taxes due at death. Making the gift from the retirement account as opposed to the will could save the children as much as \$87,500 in taxes! A charitable recipient is not subject to income taxes upon receipt of an IRD asset.



Unfortunately, there is still an IRD tax due on the remainder of the plan assets received by the children, which could amount to as much as \$87,500 in taxes.

### Contribution To A Charitable Remainder Trust

Perhaps the most useful technique to minimize the adverse tax effects of IRD and maximize the benefits available to children and other heirs is to distribute the plan assets to a charitable remainder trust. The goals of this type of planning are to eliminate IRD tax, enable the children to enjoy the economic benefits of the retirement plan proceeds, and provide a substantial gift to charity.

The Charitable Remainder Trust (CRT) pays an income to individuals for a term of years or their lifetimes, and then the principal that is left in trust goes to charity. The CRT is a tax exempt entity and is not subject to the IRD tax. It also provides a charitable estate tax deduction for a portion of the amount placed in trust. If the CRT were set up to pay 10% of the initial value of the assets for 10 years, it would have the following consequences in the above-mentioned estate:

	<u>No CRT</u>	<u>CRT</u>
<i>Estate Value</i>	\$1,250,000	\$1,250,000
<i>IRD Tax</i>	\$175,000	-0-
<i>Amount in CRT</i>	-0-	\$500,000
<i>Net to Family at Death</i>	\$1,075,000	\$750,000
<i>10-year Income from Retirement Assets (8% rate)</i>	\$260,000	\$500,000
<i>Net Total to Family (10 years)</i>	\$1,335,000	\$1,250,000
<i>Gift to Charity (after 10 years)</i>	-0-	\$500,000

The children receive approximately \$87,000 less with the CRT; but all income and estate taxes have been avoided, and a significant gift of \$500,000 to charity will be made.

Because of the tax-free accumulation and growth that occurs in retirement plans, the government has gone to great lengths to build a complicated tax structure to reclaim any lost tax revenue. Fortunately, the tax code has continued to protect charitable planning, which is one of the few ways left to ease the tax burden from retirement plans at death.