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The First Pocket for Giving

Douglas E. Olson, CFRE
Senior Vice President – North Central Region
Thompson & Associates
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Since their inception, Individual Retirement Accounts (IRAs) and other qualified pension plans have become popular means of building wealth to provide income during retirement. Today, billions of dollars of assets are owned through these tax-advantaged savings vehicles.

Even with the minimum distribution rules for mandatory withdrawal (required minimum distributions – or RMDs – begin at age 70 ½), many of these plans will still have large balances at the death of the owner or surviving spouse.

A Tax Trap for Family

If the largest asset in your estate is your retirement plan, you may be surprised to learn that these tax-advantaged savings vehicles can become tax traps when you direct any balance to a non-spouse beneficiary. Income taxes embedded in retirement assets are over and above the estate tax that will be calculated for all assets in your total estate.

Generally, the undistributed balance of qualified retirement plans is fully includable in your gross estate for estate tax purposes. Since the funds in retirement accounts usually represent deferred compensation that has not been subject to income tax, giving the accounts to individual heirs exposes the funds to significant income taxes. Your retirement dollars can be seriously depleted by this double taxation.

It is common for individuals to assign contingent benefit of retirement assets, after a spouse, to their children. It would appear to be a natural and generous thing to do this. However, the reality of such transfers is often a dramatic shrinkage of the account balance, as nearly 70% of heirs opt to take the lump sum available (rather than a stretch-out) and pay whatever income tax is due.

The double tax consequence for retirement accounts, when estate taxes are combined with income taxes, can be very unfavorable. The range varies by estate size, but as much as 60-75% of retirement assets can be lost in this double tax trap.

The Best Asset to Give Away

Because of these tax realities, retirement accounts become the first place to look as a "giving pocket" for families who have identified some level of charitable intent for their estate plan. With the taxes that can be saved in giving away some or all of these highly taxed assets, it actually makes the cost of giving less than in giving other assets.

Furthermore, with the higher federal estate tax exclusion levels seen recently, more and more estates are not subject to federal estate tax. For families, this means that with proper planning all or most non-retirement assets may often be passed on to heirs without tax consequence. That leaves retirement accounts, for many families, as the major tax concern. For those with interest in directing social capital dollars to charities of choice, rather than to Uncle Sam, retirement accounts become the ideal pocket for giving.

How to Give Your Retirement Account

The simplest way to leave the balance of a retirement account to charities of choice after your (and spouse's) lifetime is to list favorite charities on a beneficiary designation form provided by your plan administrator. Never make a beneficiary change, however, before discussing your desires with your professional advisor. For an IRA or Keogh plan you administer personally, notify the custodian in writing and keep a copy with your valuable papers.

If you are married, your surviving spouse is entitled by law to receive the entire amount of most qualified plans. You may either make your spouse the primary beneficiary of the retirement account (normally the case), or a spouse may agree to execute a written waiver or disclaimer allowing direct distribution to charity at your death. It is most common, where a gift to charity is desired, that the charity(ies) be named as secondary beneficiaries of the account.

Indeed, many families with charitable intentions see retirement accounts as the primary or exclusive asset source for charitable estate giving. The question often becomes, "what percentage of retirement accounts should be directed to heirs, and what percentage should be directed to charity?" The percentage to each may be set at any amount between zero and one hundred. But again, the concept is that retirement accounts are a preferred "pocket" for estate giving. And any amounts left to heirs become subject to potentially large taxation by increasing ordinary income.

Options for Giving

Gifts from retirement accounts may be directed to charity according to your interests and personal needs.

- A *direct distribution* to your charities of choice may help to build endowment (existing or new) and provide ongoing support for a cause important to you.
- A testamentary transfer of your selected portion of retirement assets can be made to a *charitable remainder trust*, providing income benefits for a term of years to family with the remaining assets directed to your charity's endowment.
- A *combination* of a direct distribution to charity to provide an immediate gift at death with all additional assets directed through a charitable trust as above.
- A creative lifetime use of retirement accounts is to use some required minimum distributions after age 70 ½ to leverage a larger *life insurance gift* for charity.

Whatever the chosen technique or goals for giving, consider your highly taxed retirement assets as a very smart "pocket" from which to make charitable estate gifts.