

The Case for Donating Retirement Assets

When clients choose to make testamentary gifts to charity of retirement assets such as IRAs and 401(k) plans, they are able to significantly reduce the tax burden of their estate and tailor their donations to fit their charitable goals.

One of the most difficult tasks financial advisors face is how to best prepare clients for the ways in which their estates will be handled after death, given the heavy tax burden that falls upon an improperly planned estate. However, one method—making testamentary gifts to charity of retirement assets such as IRAs and 401(k) plans—not only will enable clients to vastly reduce taxes but will also allow them to tailor their donation plans to fit their charitable goals. Community foundations are an excellent vehicle through which to donate retirement assets in order to support cherished causes and create a lasting legacy.

Making a Difference

Donating retirement assets can even save a charity's life. Some time ago, an organization aiding disabled children faced a major cash crisis and was forced to consider closing its doors. Unexpectedly, a donation of retirement assets from a recently deceased patron was announced. According to one financial advisor who was on the board at the time—Daniel Moisand, a principal at Spraker, Fitzgerald, Tamayo & Moisand, LLC, in Melbourne and Maitland, Fla., and the volunteer president of the Financial Planning Association—"The influx of cash basically saved the whole outfit—all of the sudden our financial worries were gone."

The nonprofit is still going strong today, Moisand says. But unfortunately, such giving remains relatively rare. "Maybe one in 20 people I talk to have contemplated leaving retirement assets to any kind of charitable entity, and I'm probably being generous," he says.

Avoiding Tax Burdens

Clients sometimes are unaware of just how much taxation their estate will face. During a client's lifetime, retirement assets build significantly with minimal tax consequences. But Ross Levin, founding principal and president of Accredited Investors, Inc., explains a typical after-death scenario. Say that upon a client's death there is a \$5 million estate, \$1 million of which is income in respect of a decedent (IRD), like a retirement plan:

- The \$1 million of IRD first loses \$400,000 to estate taxes.
- The remaining \$600,000 is then distributed outright to descendants. The descendants may pay income taxes in the 35 percent range, which whittle away another \$200,000 (actual tax depends on the recipient's bracket).
- At the end of the day, there is only \$400,000 left for descendants to share and possibly contribute to charity.

On the other hand, by donating the entire amount of the IRD upon a client's death, there is no tax burden. "The charity gets the full benefit of the million dollars," Levin says.

Deciding When to Donate

Currently, the maximum tax advantage from giving retirement assets to charity applies only to donating them upon death. Substantial gifts of IRA assets while alive can be troublesome. The client must first take a taxable distribution from

his or her IRA. He or she can then donate the distribution to a charity and receive a charitable deduction. However, in many situations, the deduction will not fully offset the increase in income, so clients will pay some tax on the gift. First, the distribution increases the client's income for the year, which may trigger or exacerbate other tax consequences, including the phaseout of personal exemptions and the 3 percent reduction in itemized deductions. Second, clients with limited income from other sources, and those who have made other substantial gifts, face a further problem in that charitable deductions cannot exceed 50 percent of the donor's adjusted gross income. The donor may carry forward the unused deduction for up to five years, but must pay tax on the amount over 50 percent in the year the gift is made. "Right now you're better giving appreciated stock to charity than pulling out assets from an IRA," Levin says.

Advisors can stress a much more palatable alternative—keeping IRA assets until death, when they can then be donated tax-free. Ed Slott, a CPA in Rockville Centre, N.Y., and publisher of the newsletter *Ed Slott's IRA Advisor*, says that, for example, if a client is planning to bequest a \$10,000 gift to charity while giving \$10,000 in an individual retirement account to his family, Slott will advise them to switch the gifts. "Leave the \$10,000 in the IRA to the charity—they won't be taxed at all," he says.

The regulatory landscape might change if clients are enabled to donate retirement assets while alive, although there is some resistance in Congress due to the potentially large loss of prospective tax revenue that could create. Such reservations have sunk a number of attempts to pass federal legislation to allow tax-free donations of retirement accounts. "If we see any kind of legislation pushed through that will allow for direct gifts of retirement plan assets to charities, it's going to explode," says Tim Swartley, executive director of Univest Foundation, Univest Corp.'s foundation.

Structuring Plans

When it comes to donating retirement assets, community foundations can play a major role. Foundations often serve as guides to local charities, pinpointing where a client's testamentary gifts would be best served or tailoring a donation to fit a client's needs.

There are a number of methods by which a client can contribute, including:

- Donating assets directly to a charity.
- Donating retirement assets into donor advised funds, to which clients' families can continue to make suggestions.
- Donating retirement assets into discretionary funds that community foundations supervise.

Donor advised funds are a popular method of contributing retirement assets, as their flexibility appeals to clients, who can designate family members to suggest how the assets should be used for charitable purposes.

Discretionary funds support broad charitable goals and include unrestricted funds, which community foundations decide how to use, and field-of-interest funds, which are targeted to specific causes or locations. The latter enables community foundations to fulfill a client's wishes even when situations change. Hans Dekker, president of the Community Foundation of New Jersey, offers this example: Someone upon death may donate to a homeless organization through a community foundation, but if the organization closes in

10 years, the investment income can be transferred to another nonprofit that works with affordable housing. "It's a way to match your intent with current needs," he says.

Conclusion

When it comes to the tough decision of how to best handle retirement funds upon a client's death, donating retirement assets to charity is both financially wise and greatly rewarding. Community foundations are an excellent philanthropic resource, offering a flexible set of solutions that make donating both easy and rewarding for generations to come.

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