Retirement Plan Assets (Low-Risk, Tax-Smart Gifts)

If someone wants to make a charitable gift to the RMS for individuals aged 70 and ½ or older, or after their death, the best option may be donating some or all of the proceeds of an Individual Retirement Account (IRA) or other qualified retirement plan, such as a 401(k) or Keogh plan. Some might be tempted to leave the money in the retirement plan to their family or other loved one, but that creates one huge disadvantage - the IRS can tax these benefits twice or even 3 times after the individual's death. Except for one's after-tax contributions, the individual's plan's death benefits are subject to federal income and estate taxes - and possibly generation-skipping taxes. Worse yet, some states levy taxes on these benefits, too. If your surviving spouse is the beneficiary of plan assets, he or she can likely receive these benefits estate tax-free, thanks to the estate tax marital deduction. But at your spouse's death, the funds will be included in his or her gross estate - unless they are spent or donated. In any event, retirement plan assets paid to your spouse are subject to income tax. With special planning, an individual other than a spouse who is the beneficiary of plan assets can benefit from a slight tax break. By itemizing on the federal income tax return, he or she can deduct any federal estate tax paid on the proceeds.

Tax-saving tactics - Charitable contributions of retirement plan proceeds are popular because they escape both estate and income taxation. Generally, if your estate is large enough to provide an inheritance for your loved ones and make charitable gifts, your best strategy is to give your non-retirement plan proceeds to qualified non-profit organizations like the RMS.

Example: Ann is a widow with one child, Alan. Her net estate of $4 million consists of a $2,000,000 rollover IRA plus $2,000,000 in other assets. She decides to give half of her estate to Alan and the other half to the RMS. If she were to die and leave each asset equally divided between the two beneficiaries, her estate would not have to pay any federal estate tax because the unified credit exempts the first $2 million and the unlimited deduction (gift to the RMS) exempts the balance of $2,000,000. But half of her IRA ($1 million would be taxed in Alan's 36 percent federal income tax bracket. Following the advice of her attorney, Ann instead decides to leave her entire IRA to the RMS and the other assets to Alan. The income tax on the IRA is avoided because the RMS can accept the gift tax-free. Alan avoids paying income tax on his inheritance.

In this example, the unified credit is sufficient to exempt Alan's share of the estate from estate tax. But if an individual's share exceeds this credit, there will be a tax as high as 55 percent. Retirement plan assets left to grandchildren may incur a generation-skipping tax, as well. Even if your estate won't be exposed to estate taxes, income taxes can be avoided by using retirement plan assets for your bequest (gift) to the RMS and leaving other assets to family members.
Example: If you are 70 ½ or older, under the Pension Protection Act of 2006, individuals can make a lifetime gift (direct transfer, free of taxes) using their IRA funds without tax complications. Previously individuals had to report money taken from their IRA as taxable income, take a charitable deduction for the gift, but only up to 50 percent of their adjusted gross income. Some donors actually paid more in income taxes than if they didn't make a gift. Now individuals can make a gift while living and able to witness the benefits of their generosity. While individuals will not pay income tax on the amount, they cannot claim a charitable deduction. You may contribute funds this way if: you are 70 and ½ or older; the gift is $100,000 or less each calendar year; you make the gift on or before December 31; you transfer funds directly from an IRA or Rollover IRA; and you transfer the gift outright to the RMS. Be sure to contact a tax professional and your IRA custodian if you are considering a gift under this new provision.