



Retirement Account Gifts: Planning Considerations

Retirement accounts, such as 401(k) plans, 403(b) plans and Individual Retirement Accounts (IRAs), are generally viewed as the better assets to leave through an estate plan to charitable organizations. When these types of accounts are the asset chosen to benefit loved ones, a combination of federal and state estate taxes, income taxes and even federal generation-skipping transfer taxes can significantly impact the net benefit, leaving little remaining for the intended loved ones.

- *State and Federal Estate Taxes:* The full, date-of-death value of retirement savings may be subject to federal estate tax, and many states impose death taxes as well.
- *State and Federal Income Taxes.* Both federal income tax and state income tax (depending on the place of residence of your heirs) will be due on death benefits from an IRA or other plan – costing up to 40% or more. Most bequests and inheritances come to heirs free of income tax – but retirement benefits (except for Roth IRAs) are fully taxed to your heirs or estate.
- Federal estate taxes (but not state death taxes) are a deduction against income tax paid by an heir. Generation-skipping transfer taxes apply when retirement savings pass to a grandchild or other “skip” person.

Estate taxes can be postponed when retirement assets pass to a surviving spouse. But an expensive visit from the estate tax and income tax collector – costing 60% or more – lies ahead, for married and unmarried individuals alike. The examples in the following chart show shrinkage that can occur for both small and large estates.

Erosion from Taxes of Individual Retirement Accounts

	Total Income Taxes	Federal Estate Taxes	Remaining for Heirs
Estate A			
(\$500,000 total estate)			
\$100,000 IRA passes to children	\$ 37,690	None	\$62,330 (62%) From original \$100,000
 Estate B (2013)			
(\$7 million taxable estate)			
\$1 million IRA passes to children	\$247,540	\$ 20,000 (State) \$392,000 (Federal) \$412,000 (Total)	\$340,460 (34%) from original



The example of Estate A assumes children are in a 33% federal income tax bracket and a 7% state income tax bracket (assuming state taxes are deductible against federal taxes).

The example of Estate B assumes heirs will be in a 33% federal income tax bracket and a 7% state income tax bracket (assuming state income taxes and federal estate taxes are deductible against federal income tax). Total state inheritance tax is \$50,000 on the \$7 million estate, \$20,000 of which is attributed to the \$1 million IRA.

A more productive option might be to leave the retirement account to support The First Church of Christ, Scientist, *and preserve all of the funds free from tax*. It is simple to leave part or all of your IRA or other retirement account to the Church. Simply obtain a new beneficiary designation form from your plan administrator. Except for IRAs, married donors will need their spouses' written consent.

Options for Arranging Bequests from Retirement Plans

Beneficiary Change. Instruct the custodian or trustee of the retirement account to name the Church as partial or 100% death beneficiary. The custodian can provide the appropriate forms. As discussed below, the account can be left partially to benefit the Church, with the rest passing to a spouse or family members.

Will or Living Trust. If no death beneficiary is named for an account, a will or living trust can provide that retirement assets are specifically designated to pass to the Church (or as part of the "residue" of your estate if we are the sole residuary beneficiary).

Trusts for Children and Others. You can make the beneficiary of your retirement account a charitable remainder trust that will benefit both a child or other family members and the Church. This may be especially helpful if your IRA will make payments to several beneficiaries that includes one or more senior beneficiaries. IRA rules state that funds must be completely distributed over the life expectancy of the most senior beneficiary. Tax and financial benefits will be better if payments can be stretched out and paid over the term of the charitable remainder trust – for 10, 15 or 20 years, rather than for life.

Charitable Gift Annuity. The IRS has approved a plan by which a donor left the balance remaining in her IRA to a charity to fund a charitable gift annuity for a family member. The value of the IRA would be included in the donor's gross estate, but there would be an estate tax charitable deduction equal to the value of the IRA, less the value of the annuity. Neither the donor's estate nor the charity would owe income tax on the IRA, but the income recipients apparently would be taxed on all payments.



Qualified Disclaimer. Members and friends may also consider making the Church a contingent beneficiary of retirement plan death benefits and giving heirs the right to disclaim (decline) part or all of their benefits. Heirs who understand the severity of taxes may decide it best to have retirement assets pass to the Church. A spouse may disclaim and have the IRA pass to a charitable remainder trust of which he or she is the lifetime income beneficiary.

Sharing with Family Members. Heirs may not need the shrunken amount that would be left from retirement assets after taxes. However, friends can make bequests of retirement accounts and purchase life insurance to replace what a family member would have kept, after taxes. Some donors prefer to leave a percentage of their IRAs to The First Church of Christ, Scientist and divide the rest among other beneficiaries. Or you can arrange for retirement death benefits to pass to a charitable remainder trust that would pay income for life or, alternatively, for a term of up to 20 years to family beneficiaries, with eventual benefit for our future.

Providing for Both a Surviving Spouse and the Church. Donors who wish to use a retirement account to benefit both a spouse and the Church have several choices:

- Make the Church a partial beneficiary of the account and leave the rest to the spouse, who could then roll over the benefits into his or her own IRA or receive distributions over his or her life expectancy under the general stretch-out rules for inherited accounts. Because the surviving spouse is not the sole beneficiary, life expectancy can't be recalculated annually.
- Leave part or all of the retirement account to a testamentary charitable remainder trust in which the spouse is the sole beneficiary (required for qualification for the estate tax marital deduction);
- Set up a charitable remainder unitrust now for you and your spouse and fund the trust initially with cash or stocks. You could make your IRA or other retirement account payable at death to the unitrust, providing security for your surviving spouse and completely avoiding federal estate taxes. Alternatively, you could simply establish a charitable remainder trust for your spouse in your will, as noted above, and change your IRA beneficiary designation to the trust.
- Ideally, where both spouses choose to provide for the Church, the surviving spouse would be made the sole beneficiary of the IRA, with the expectation that he or she would leave part or all of the rollover IRA to The First Church of Christ, Scientist. Of course, the first spouse to die would have no absolute certainty that the Church eventually will benefit under this reliable spouse strategy.



Strategies for Roth IRA Conversions

All taxpayers – regardless of income – are eligible to convert traditional IRAs to tax-free Roth IRAs, guaranteeing that future withdrawals would be free of income tax, both for themselves and their heirs. The downside is that converted amounts generally constitute taxable income.

Deciding whether to convert from a traditional IRA to a Roth IRA can be complex. Will you be in a higher or lower tax bracket in future years? Will your heirs' tax brackets be lower than your own top rates?

All of these murky questions could be swept aside if it were possible to minimize the taxes resulting from a Roth conversion. In fact, there may be a simple solution: If your estate plan contains large charitable bequests, you could accelerate those bequests into current gifts, and use the charitable deduction to reduce or avoid income taxes.

Donors also might bunch four or five years' worth of annual gifts into the current year, or prepay multi-year charitable pledges. Charitable remainder trust beneficiaries who feel they no longer need their annual payments can secure large deductions by assigning income interests to charitable remaindermen.

What if donors feel they don't have the cash flow to accelerate charitable bequests? One strategy would be to deed part or all of a primary residence, vacation home or farm property to The Mother Church, while reserving a life estate. Charitable deductions are currently high for such arrangements, due to low interest rates used in calculating deductions.

Another possibility is to make a gift that provides a large deduction and lifetime income as well, through a charitable gift annuity or charitable remainder trust. Donors can enlarge these deductions by postponing the initial payment from a gift annuity for several years.

Here is an example:

Judith, age 55, is executing a Roth IRA conversion and needs to increase her itemized deductions. She decides to transfer \$100,000 in securities to The Mother Church, in exchange for a charitable gift annuity that will initiate payments when she turns 67. Age 67, however, is merely an estimate of when she might retire, and Judith would have the option to start payments later or earlier, depending on circumstances.



Judith can deduct roughly \$45,000 this year as a charitable gift and will receive payments of \$7,300 (7.3%) at age 67. But if she decides to continue working past age 67, or for any reason wishes to postpone the start of annuity payments, her payout will increase. She could elect to get her first check at age 70 and be paid 8.5%, or receive 9.7% by starting at age 72.

If Judith found it desirable to start her annuity before age 67, she could do so at a reduced payout rate. Her charitable deduction, which smoothes the path to her Roth IRA conversion, is unaffected by her choice of when she initiates payments.

How to Proceed

Making The First Church of Christ, Scientist the beneficiary of a retirement account is essentially a matter of completing a beneficiary form provided by your account manager. If you are interested in providing for the Church through your retirement plan, please e-mail, call or write our office.

We are pleased to advise you:

1. Our correct legal name, for use in filling out the beneficiary designation
2. Suggested language to fit any special needs or circumstances

You will need to share with us:

1. The type of retirement plan in which you participate: 401(k) plan, 403(b) plan, Individual Retirement Account, etc.
2. Whether you are currently married (except for IRAs, a spousal waiver will be required)
3. The amount you intend to leave to the Church
4. Your wish, if any, to reserve lifetime income from your bequest for a family member
5. Contact information (address and telephone) of the manager of your account

You can contact our office at philanthropy@cspcs.com, by phone at 1-800-288-7155, extension 3288, or write to us at the address below. We look forward to hearing from you.

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Computation Notes on the Examples of Estate A and Estate B

Income taxes on Estate A's IRA include \$7,000 of state income taxes, which are a deduction against his federal taxes. In Estate B's estate, the federal estate taxes and state death taxes on her total \$7 million estate are \$730,000: \$50,000 in state inheritance taxes and \$680,000 federal estate tax (assuming death in 2013). Omitting the \$1,000,000 IRA from the taxable estate leaves \$288,000 estate tax and an assumed state inheritance tax of \$30,000 on the remaining \$6,000,000. State and federal "death taxes" attributed to the IRA are therefore \$20,000 state and \$392,000 federal (\$412,000 total). The \$392,000 of federal estate tax (but none of the state death tax) provides an IRD income tax deduction. State income tax is based on the full \$1,000,000 (assuming a 7% rate), equaling \$50,000. Federal income tax would be \$1,000,000 minus \$392,000 of IRD deduction for federal estate taxes, minus \$70,000 state income tax, equaling \$538,000, times 33% equals \$177,540 federal tax. Add state income tax of \$70,000 and the total income tax is \$247,540. Shrinkage of Estate B's IRA, accordingly, is \$1 million minus \$412,000 in state/federal estate tax, minus \$247,540 of combined income tax, for a total of \$659,450 lost to taxes, leaving only \$340,460 for heirs (34¢ on the dollar).