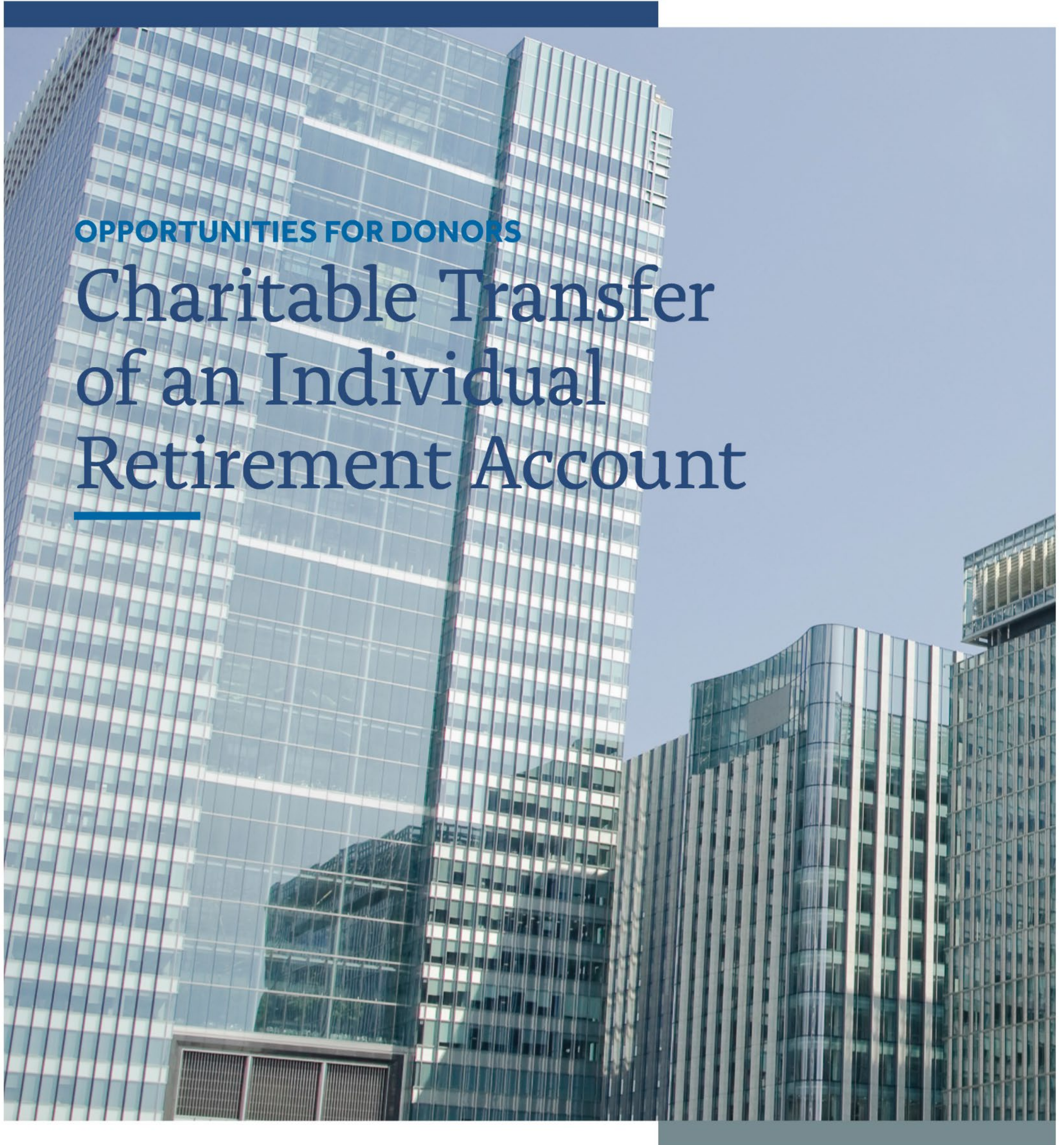
Charitable
Corner



OPPORTUNITIES FOR DONORS

Charitable Transfer of an Individual Retirement Account

Charitable Transfer of an Individual Retirement Account

The taxes applied to retirement plan assets transferred at death can be significant. Using those same assets to fund an outright gift to charity, a charitable remainder trust, or a charitable gift annuity instead can greatly reduce those taxes, benefitting both the donor's heirs and the charity. One strategy in particular, the charitable individual retirement account (IRA) rollover, has received a great deal of attention over the last few years, especially since it was made permanent by the PATH Act of 2015. However, it is not the only qualified asset than can be contributed to a charitable organization. All qualified retirement plans, including 401(k) and 403(b) plans, can be used to make tax-efficient charitable gifts at the owner's death, not just traditional IRAs.

Taxation of retirement plan assets

Typically, the assets in a retirement plan or IRA have never been taxed until they are distributed. Consequently, these distributions are subject to income tax at the beneficiary's income tax rate, which can be as high as 37%, more if the beneficiary resides in a state with an income tax. In addition, retirement plan assets given at death are subject to estate tax, and if grandchildren (or other "skip persons") receive the distribution, the generation-skipping transfer tax also applies. That's potentially three separate federal taxes. For the small fraction of estates large enough to pay estate tax, retirement plan assets can be assessed a combined tax rate of 70% or more.

To the extent that the donor wishes to make charitable gifts at his/her death, he/she can reduce these taxes the most by funding these gifts first with what remains in his/her retirement account. If that amount is not sufficient, only then does it make tax sense to use other assets in the estate to make up the difference.

Outright gift

The simplest way to make a gift of retirement plan assets at death is outright. The donor would request a beneficiary designation form from the plan administrator, identify the charity or charities he/she wishes to designate as beneficiaries of the plan when he/she dies, including the percentage of the remaining balance each charity should receive, then return the form to the administrator. Most retirement plan administrators will insist that the donor designate a percentage of the remainder, rather than a specific dollar amount, since it is uncertain what the plan balance will be when the donor dies. It is best that any restrictions on how the charity may use the funds be described in a document provided to the charity rather than on the beneficiary designation form itself. This approach assures that the charity is aware of the restrictions and gives it the opportunity to discuss with the donor any questions about them.

Charitable remainder trusts

For a donor who wishes to support a charity with an estate gift and provide an income stream to one or more of his/her heirs, using retirement plan assets to fund a testamentary charitable remainder trust (TCRT) can be a good way to accomplish both goals. Such a transfer likely would not trigger federal income tax on the entire balance. Rather, this income tax is applied only as this income is distributed to the income beneficiaries of the charitable remainder trust.

Since only a very few estates are large enough to owe estate tax, such a transfer typically creates no federal estate tax. For estates that are large enough to owe federal estate tax, a transfer of retirement plan assets into a charitable remainder trust is eligible for an estate tax deduction equal to the charitable remainder value of the trust. As a result, even with very large estates, retirement plan assets that are designated to fund a charitable remainder trust at the owner's death are typically subject to a combined tax rate of 20% or less.

The dramatic reduction in taxes makes funding a TCRT at death a very low-cost gift for the donor's heirs and charity.

Charitable gift annuities

A donor can accomplish similar goals by funding a charitable gift annuity with assets left in his/her retirement plan. The numbers will work out somewhat differently and will depend on the age of the annuitant and the annuity rate offered. The assets transferred to fund the gift annuity will not be included in the donor's estate for income tax purposes and the estate will be allowed a deduction for the charity's interest in the assets. The conservative approach is to treat payments as entirely ordinary income.

Funding a gift annuity rather than a charitable remainder trust may be more attractive to donors who are already familiar with gift annuities because they have funded one during life, who like the relative simplicity of setting one up, or who are considering a gift amount that is too small to support the administrative costs of a charitable remainder trust.

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