www.lawyersusaonline.com
LawyersUSA

Practice makes perfect. Sub
SIGN
FREE
E-ma

Wednesday, July 12, 2006

From the September 25, 1995 Lawyers USA.

Order a REPRINT of this Story

Front Page Story

Money Left to Charity Should Always Be From IRA or 401(k)

Even for Estates Under $600,000

By Susan A. Cardoza

People who want to give money to charity when they die should use funds in an IRA or 401(k) rather than other estate assets, estate planning experts are advising.

ADVERTISEMENT

Get client newsletters tailored to your practice areas!
Click here for more information.
Legal Matters
Legal Matters

This is a big tax savings for anyone -- not just for clients with estates over $600,000.

The reason: If you leave IRA or 401(k) money to a person, the person will have to pay income tax on it -- whereas if you leave it to a charity, it's tax-free.

"You get a lot more bang for your buck if you do this," says New York tax attorney Jerold Zieselman.

The idea of using IRA's and 401(k)'s to fund charitable bequests is "new and rapidly developing," says Donna Barwick, an estate planner in Atlanta.

The underlying rules aren't new, but the issue is coming up more and more because clients increasingly have large amounts of money in retirement plans, experts say.

IRA's and 401(k)'s are "the perfect asset to give to charity," says Jeff Baskies, who practices in Fort Lauderdale, Florida. "If you're going to give money anyway, give this money."

How to Do It

To leave an IRA or 401(k) to charity, all you have to do is designate the charity as the beneficiary of the account. It's not necessary to leave the entire amount to charity; you can designate a specific dollar figure.

While this is simple, there are two important traps to watch out for, experts say:

Trap #1. Don't leave the IRA or 401(k) to your estate and then bequeath the money to charity in your will. If you do, your estate will have to pay the income tax and you'll lose the entire tax advantage, says Roger Shumaker of Cleveland.

"Because you would be using the IRA or 401(k) to satisfy a pecuniary gift, the estate would realize income on that use," he says. "By going through the estate you could step in a big hole and have income tax when you don't expect it."

Boston sole practitioner Natalie Choate says, "The number one rule is you don't want the money to pass into your estate."

Trap #2. If you want to leave less than the full amount in the IRA to charity, make sure the desired amount is put into a separate account.

You can do this by stating in your beneficiary designation, "As of the date of death x dollars will be set aside in a separate account," says Boston attorney Virginia Coleman.

You can also set up a separate account at the time the distributions are scheduled to start. (Under IRS regulations, they must start by age 70 1¼2.)

The reason is that if you don't put the charity's portion in a separate account, then all the beneficiaries of the IRA will have to be paid out at the same rate as the charity, which the law requires to receive full payment within five years.

This is a problem because the other beneficiaries may want to be paid over a longer time span in order to spread out the income tax they'll have to pay.

Failing to create a separate account means that, "The charitable piece will taint the whole," says Coleman.

Put It in a Trust?

Another idea is to name a "Charitable Remainder Trust" as the beneficiary of an IRA or 401(k), experts say.

In this type of trust, a beneficiary receives income for life and the corpus goes to charity when the beneficiary dies.

There are three situations in which this can be an advantage:

Situation #1. The testator wants to take care of his or her spouse for life and then have the money go to charity.

The usual way of doing this is for the surviving spouse to simply roll the money over into his or her own IRA, and then leave that IRA to charity.

If you do this, however, the surviving spouse will be subject to all of the IRS regulations governing when and how much money must be drawn down from the account. By contrast, if you set up a charitable remainder trust and name the surviving spouse as the beneficiary, decisions about when and how much money is distributed can be made by the clients, not the IRS.

The bottom line is that you get the same tax advantages as a rollover and much more flexibility.

Situation #2. Where a child beneficiary of an IRA would otherwise have to take the full payment over a short period of time.

Ordinarily, if an IRA owner names a child as a beneficiary before passing away or turning 70 1/2, the child can draw down the IRA over his own life expectancy. This permits him or her to spread out the income tax payments over time.

But if a client is over 70 1/2 and made the mistake of designating his estate or a revocable trust as the beneficiary when he started receiving distributions, his children could be forced to accept full payment within a very short period.

"The IRS says that since you didn't have an individual designated beneficiary as of your required beginning distribution date, your child can't take distributions over his life expectancy," says Choate.

In such a case, the distributions must be made according to the IRA owner's life expectancy.

If the IRA owner chose to accept payments according to a fixed life expectancy calculated when he was 70 1/2, there may only be a few years left when he dies and the beneficiary will have to take all the payments in those years.

Worse, if the IRA owner chose to accept payments according to his life expectancy as it is recalculated every year, the beneficiary will have to take the entire remaining sum in one year (since in the year the IRA owner dies, his life expectancy is zero).

Setting up a trust would enable the children to spread out the income over the rest of their lives, says Choate. "A trust can slow down payments if you're in a situation where the money is going to be paid out over too short a period of time."

However, the corpus will go to charity when the child dies, so this is generally only a viable option if the IRA owner wants to make a charitable bequest in any event.

Situation #3. If the client is participating in a 401(k) plan that pays death benefits in a lump sum rather than installments.

This is essentially the same situation as the IRA owner whose children have to take out all the money in one year.

"If you're leaving your 401(k) benefits to a child, the plan might not allow the child to do an installment payout," says Choate. "That's another good example of when you might consider a charitable remainder trust, because you're not going to quit your job to roll everything into an IRA."

© Copyright 1995 Lawyers Weekly Inc., All Rights Reserved.

Order a REPRINT of this Story

LawyersUSA Try 6 Weeks Free
■ Newspaper

User Agreement For Subscriber-Only Online Benefits | Help | Our Privacy Policy

Send any questions or comments to comments@lawyersweekly.com

Subscriber Services: 1-800-451-9998 **Technical Support**: 1-800-444-5297 ext. 8156

© Copyright 2006 Lawyers Weekly, Inc. All Rights Reserved

DOLAN MEDIA COMPANY

Lawyers Weekly does not use spyware; however, we link to a number of other sites and do not take responsibility for any spyware they

This site is best viewed with Internet Explorer 6 (click here to download) or Netscape 7 or higher (click here to download)

208.49.101.98/5.93