

Leaving Your IRA Assets to Charity ©

Eileen Gunn , CFA

If you leave your individual retirement account (IRA) to a family member other than your spouse, your heir might pay as much as 77 cents on every dollar in accumulated income tax and estate tax¹ more than on other kinds of assets you might bequeath. But those levies disappear when the beneficiary is a tax-exempt charity. "The charity gets 100 cents on the dollar," says George Cushing, an estate attorney with Kirkpatrick & Lockhart in Boston, Massachusetts.

With many charitably minded Americans accumulating most of their wealth in retirement accounts, donating assets from an IRA to charity can make good estate-planning sense. More and more often, I see estate plans where the bulk of the estates value is in the IRA, says Tom Cullinan, a consultant who trains not-for-profits in fund-raising strategies. And this is typically the last asset people draw down.

Moreover, IRAs are very flexible. You can change the accounts beneficiaries and how much each beneficiary receives as often as you like during your lifetime. All you need to do is update the beneficiary designation form that's on file wherever you have that account. "Revocable gifts [[ike IRAs] give you the freedom to change your mind if you have a reversal of fortune or if the tax laws change," says Cullinan.

Long Division

Several advisors urge their clients to turn to their IRAs first for charitable bequests, even though this typically means delaying the gift until both spouses have passed away.

However, it's possible to do all the charitable giving you want to do and still have money left in your IRA. You would expect to simply direct the surplus money to your family. But because individuals have natural life expectancies and organizations don't, when you try to make them co-beneficiaries of one IRA, the tax rules around any distributions from the IRA get complicated. If the account isn't managed the right way, your heirs could be forced to take their full distribution within five years of your death (instead of over their lifetimes) and pay a hefty income-tax bill as a result.

The simplest way to avoid getting your heirs tangled up in punitive tax laws is to divide one large IRA into multiple accounts that separate your charitable gifts from your family's inheritance, says Ed Slott, a CPA and nationally recognized IRA distribution expert. With the charity out of the picture, your heirs will be able to stretch distributions out according to a formula based on their life expectancies. "I've seen people have one IRA each for several charities. I've also seen one IRA divided among a few charities," in addition to one meant for family members, says Cullinan.

The number of accounts you have doesn't affect the annual distributions you and your spouse have to take while you're alive, which provides additional flexibility. "You can decide that you want to leave \$500,000 to charity and roll that into one IRA. Then you can take your distribution from the gains that

accumulate, so it stays at \$500,000," suggests Marvin Rotenberg, national director of retirement services at Fleet Private Bank in Boston. "Or if those assets decline in value one year, you can take more of your distribution from another IRA that performed better."

Keeping the Assets Together

There are also some advantages to keeping IRA assets in a single account. "[Clients] don't want to pay extra fees on multiple accounts or have to watch all these different balances," says Slott.

And keeping the money all in one place can provide a different kind of flexibility in planning bequests. "I had one client who said he wanted to give \$100,000 to his church and the rest to his children, unless there was less than \$100,000 left in [the IRA] when he died. In that case, he wanted it all to go to his children," says Kirkpatrick & Lockharts Cushing. Cullinan knew someone who asked his executor to give away every last dollar he could to get below the threshold for estate tax. These kinds of instructions might be harder to orchestrate if the assets are spread over different accounts with multiple beneficiary forms.

A clause written into the tax code in 2002 makes it easier than it once was to divvy up one IRA after you're gone, though advisors prefer clients not rely on it. Here's how it works: You have until September 30 of the year after the account holder dies to let the IRS know who will be receiving distributions from the account. As long as the charity takes its distribution before this plan is submitted, it no longer has an interest in the IRA and can be excluded from the plan. The result is that your heirs can take their distributions over their lifetimes, as though the charity hadn't been involved.

Communicate Your Intentions

If you decide to stick with a single IRA, Rotenberg recommends leaving a letter of instruction and copies of all your beneficiary forms alongside your will. He also advises that you make sure that anyone who needs to know—executor, attorney, accountant, a key family member—has copies of everything.

The problem of keeping assets in one IRA and not writing a letter of instruction, Slott and other experts say, is that you're counting on others to do things in a precise order by a particular deadline after you're gone. "People will figure out what you wanted eventually, but it could be a mess until they do," he notes. If your family and advisors don't know quickly enough where your retirement account is held, if the financial firm has misplaced your beneficiary form, or the form doesn't clearly explain what you want, it could take longer than you prefer to sort things out.

It's also a good idea to let the charity know to expect a gift, even if you don't reveal details about the amount or the form it will take. "A lot of people never tell the charity because they want to be able to change their minds, or they don't want to call attention to themselves, or because they think it will be a nice surprise," says Slott. "But in this instance, the more people who know your intentions, including the charity, the better the chances that they will be carried out."

For example, when donors leave IRA assets to Rochester Area Community Foundation in New York, they sometimes leave instructions in terms of what to do with the money on file with the foundation. "We draw up an agreement that describes what type of fund they want to create," notes Jennifer Leonard, executive director and president. "Donors might name specific charities they want to support. They can also describe the kinds of causes they want to fund #&153;arts in schools, for example, and give the foundation discretion in choosing appropriate organizations." "They can change or update that agreement as much as they need to, because it doesn't go into effect until its funded," she says.

A smart donor will say to the recipient, "I've made you the beneficiary of my IRA. It's held at Fidelity, and this is the account number and my contact person," notes Brad Britton, director of planned giving at the Cincinnati Area Foundation in Ohio. "Others will at least let us know generally that we're going to receive this asset."

Britton says, "the foundation prefers it that way, so it can get to know the donor and understand his or her charitable interests and goals. Surprises are nice, but they're not necessarily the best way to have your intentions carried out," he notes.

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