*Honor the last generation. • Enlighten the next. • Leave a legacy bequest to the Museum.*

# Retirement Plan Assets:

## A Smart Way to Secure Your Legacy


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Like many Americans, you are probably aware that the accumulation of assets in your retirement plan can be the basis for a financially secure future. To preserve your retirement assets after your lifetime, consider the benefits of using them for a charitable gift.

Retirement accounts are often exposed to income taxes and estate taxes, at a combined marginal rate that could rise to 65 percent on large taxable estates. Yet many of these taxes can be avoided or reduced through a carefully planned charitable gift.

Other considerations come into play when deciding on using retirement plan assets for charitable giving. Upon death, your account can pass directly to the Museum as your primary beneficiary, or it can be transferred to a deferred giving arrangement that will pay an income for life to a family member, after which the remaining assets pass to the Museum.

## How Retirement Accounts Are Taxed

Qualified retirement plans are those that receive favorable income tax treatment during an employee's lifetime. No income tax is due on the funds as contributed, and no income tax is due on the earnings and appreciation while in the plan. You pay taxes on the funds only when you receive them. Such plans come in many forms: a defined benefit or contribution pension plan, money purchase pension, profit-sharing plan, annuity plan, 401(k) or 403(b) plan, stock bonus plan, employee stock ownership plan (ESOP) or simplified employee pension (usually a SEP-IRA) from your workplace, and Keogh accounts and individual retirement accounts (IRAs) you set up for yourself.

Generally, the undistributed balance of qualified retirement plans is fully includable in your gross estate for estate tax purposes. Because the funds in retirement accounts usually represent deferred compensation that has not been subject to income tax, giving the accounts to individual heirs exposes the funds to income taxes. Your retirement dollars can be seriously depleted by this double taxation.

A qualified retirement plan often makes a large taxable distribution shortly after an employee's death. As a general rule, qualified plans other than IRAs will specify how quickly distributions must be made from the plan. In the case of an IRA, if the owner dies before reaching the required beginning date (i.e., the date a person must begin receiving distributions from his or her retirement plan), the plan benefits may be distributed over the life expectancy of a "designated beneficiary." The designated beneficiary refers to a person, not the owner's estate or certain trusts. If the IRA does not have a designated beneficiary, then the IRA must be distributed within five years. If the owner dies after the required beginning date, then the entire balance can be distributed over what would have been the owner's remaining life expectancy or over the designated beneficiary's remaining life expectancy.

Beneficiaries who are not designated beneficiaries should have their share distributed to them by Sept. 30 of the year following the year of death. This allows the designated beneficiaries to stretch out the receipt of distributions from the plan over their lifetimes and, hence, defer the income taxes, too. Of course, the beneficiary always has the option to speed up his or her distributions or to take the balance in a lump sum at any time.

Only a surviving spouse can roll over an inherited distribution to his or her own IRA, called a Spousal Rollover IRA, and further delay receiving distributions until his or her own required beginning date; all other beneficiaries must take distributions and are taxed according to the above rules.

## Income in Respect of a Decedent

The Internal Revenue Code (IRC) labels amounts that were not previously included in a decedent's taxable income as items that generate "income in respect of a decedent" (IRD). In plain language, these are amounts that would have been taxed as income had the recipient lived long enough to receive them. In addition to qualified retirement plans, IRD items include accrued interest on certificates of deposit and savings bonds, unused vacation pay, nonqualified stock options, deferred payments of capital gains and other undistributed but earned income. Among all your assets, the largest IRD source will probably be your retirement accounts.

By donating retirement assets, those funds avoid estate and IRD taxes, and you can be certain that 100 percent of the balance of your retirement funds will support your philanthropic objectives.

> **Example:** Bill is considering adding a charitable bequest to his will, with the residue of his estate passing to his children. Instead, he should name the Museum as beneficiary of his profit-sharing account. The death benefit passing to the Museum will not only qualify for the estate tax charitable deduction, but will also pass free of any income tax obligation. His children will benefit from this change because, rather than getting the profit-sharing account proceeds that are subject to income tax, they will receive other assets of his estate that are free of income taxes.
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> Continuing the example, suppose Bill owns stocks that have a low cost basis. He can secure a further tax advantage by leaving these to his children. They will receive a step-up in the income tax basis to the date-of-death value of the stocks. Since the basis is the amount from which any gain or loss will be figured when the children ultimately sell the property, this means there will never be a tax on the appreciation that occurred during his lifetime. The children will owe tax only on appreciation after the time of Bill's death.

## Leave Your Retirement Account to Charity

The simplest way to leave the balance of a retirement account to the Museum after your lifetime is to list us as the beneficiary on the beneficiary form provided by your plan administrator. Never make a beneficiary change, however, before discussing your desires with your professional advisor. For an IRA or Keogh plan you administer personally, notify the custodian in writing and keep a copy with your valuable papers.

If you are married, your surviving spouse is generally entitled by law to receive the entire amount in these qualified plans: money purchase pension, profit-sharing plan, 401(k) plan, stock bonus plan, ESOP or any defined benefit or annuity plan (though not an IRA). In order for the assets to be given to a charitable organization, your spouse must sign a written waiver (even though you may designate a charitable organization as beneficiary on your employer's forms). Your spouse can sign the waiver after your death, if necessary. In that case, the document must also include a qualified disclaimer.

If you prefer to make your spouse the primary beneficiary of the retirement account, you can name us as the secondary or contingent beneficiary.

Perhaps you want your children to benefit from your retirement account, too. In that case, you might designate a specific amount to be paid to us, before the division of the rest among your children.

## Required Distributions

Once you reach age 70½ or the year you retire, if after age 70½, you are required to begin taking payments from your qualified retirement plans if you have not yet done so. However, owners of IRAs or those who own 5 percent or more of the business offering the retirement plan must take their minimum distributions at age 70½ even if they haven't retired.

It is much easier to name the Museum as the beneficiary and still minimize the required distribution amount. The designation of the Museum as the beneficiary of a portion of the plan benefits will not increase the employee's minimum required distribution, despite the fact that the organization would not qualify as a designated beneficiary. As stated earlier, it is preferable that the amounts are paid to the charitable organization before Sept. 30 of the year following the year of the employee's death.

## Life Income for Survivor

Another tax-benefiting possibility is to transfer retirement assets at death to a tax-exempt deferred giving plan, such as a charitable remainder unitrust or a charitable remainder annuity trust. The trust's income beneficiary you designate will receive an income generally for life, either a fixed percentage of the value of the trust assets as revalued annually or a fixed dollar amount. After his or her death, the remaining principal will support our work.

By naming a deferred giving plan as the ultimate beneficiary of your retirement account, income taxes can be deferred until paid to the income beneficiary you designate. This may offer the only income tax deferral opportunity for your heirs if your retirement plan requires an immediate distribution.

> **Example:** After participating in her company's profit-sharing plan for many years, Anne estimates that when she dies, the account balance could be at least $200,000. If she were to name her daughter, Sandy, as the beneficiary, the entire amount would go to Sandy as ordinary, taxable income, incurring federal income taxes of up to $70,000. In addition, federal estate taxes would be due if Anne's other assets equaled more than the amount exempt from estate tax, leaving as little as 35 percent of the $200,000!

Instead, Anne creates a charitable remainder unitrust and names it as the beneficiary of her profit-sharing plan. She arranges for the unitrust to pay 7 percent of the value of the assets to Sandy each year for life. The net result is significant income tax deferral. The entire $200,000 can be invested to produce investment income. The estate tax on the value of Sandy's interest would typically be paid from other assets. The partial estate tax charitable deduction for the present value of the charitable remainder interest will reduce Anne's estate tax.

## New Legislation Makes Lifetime Gifts Easier

So far, our discussion has related to arrangements after your lifetime. But under the Pension Protection Act of 2006, you may use IRA accounts if you are 70½ or older to make gifts during your lifetime without any undesirable tax effects. Prior to the new law, you would have to report any amount taken from your IRA as taxable income, then take a charitable deduction for the gift, but only up to 50 percent of your adjusted gross income. In effect, this caused some donors to pay more in incomes taxes than if they didn't make a gift at all.

Fortunately, through Dec. 31, 2007, these IRA gifts can be accomplished easily and without unnecessary tax complications. Plus, you can make the gift to a qualified organization (excluding charitable trusts, donor advised funds or supporting organizations) while you are living and able to witness the benefits of your generosity.

To be eligible for the special tax treatment, you must be at least 70½ years old on the day you make the gift. The maximum amount you can give from your IRA is $100,000 for 2006 and $100,000 for 2007. If desired, your spouse, if 70½, can also give $100,000 per year from his or her own IRA.

Plus, if you don't need your required minimum distributions, you can transfer those payments directly to an eligible organization and you won't have to pay income tax on the required distributions as long as your IRA gifts total $100,000 or less for the year.

You make a gift simply by contacting your IRA custodian to make a direct transfer from your IRA to the organization (make sure to notify the charitable organization as well). Be sure to have the IRA custodian send the funds electronically or by a check made payable to the charitable organization. If the custodian makes the check payable to you, and you deposit it into your bank account and write a personal check for the charitable gift, you will not be eligible for the special tax breaks.

## Valuable Estate Planning Strategy

Using funds from your retirement plan account may be the most tax-effective means of making a charitable gift. Because the laws vary depending on when and how you make the gift, and to receive the most tax benefits from your philanthropy, please seek guidance from an attorney and other professionals who are thoroughly versed in this area of tax law.