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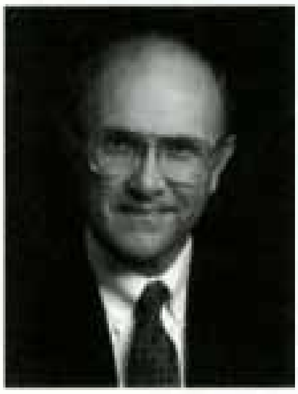
Estate Planning with Retirement Plan Assets

By Jon H. Trudgeon



Jon H. Trudgeon

Mr. Trudgeon, an attorney with Speck, Philbin, Fleig, Trudgeon & Lutz, has written numerous articles on Tax-Exempt organizations, Qualified Retirement Plans, and has spoken to the Oklahoma Planned Giving Council and at continuing legal education programs on Estate Planning with Retirement Benefits.

A growing portion of the wealth held by individuals who are at the age for serious consideration of estate planning is now in the form of "defined contribution" qualified retirement plans and IRAs. Many of these individuals have done better financially than they ever expected, and continue to do so. As a result, some have not taken the retirement income available to them. These assets are quite different from other assets in that they represent pre-tax accumulations. Therefore, the estate planner must consider both income tax and transfer tax consequences. Not only is the value of the benefits included in the decedent's estate, for estate tax purposes, but the beneficiary is also subject to income tax upon receipt. Add in the possible effects of various excise and additions to estate taxes and you have an area where the estate planner can often arrange for substantial tax savings and or tax deferral for his or her client and the beneficiaries.

The task of minimizing taxes on the distribution of retirement benefits to participants and beneficiaries can be daunting. Expertise in both pensions and estates will be required: Pension lawyers are often not expert with estate and gift tax rules or familiar with all the available estate planning tools, and estate planning lawyers are not always versed in the income tax rules unique to the distribution of retirement benefits. Planning for the receipt of retirement benefits from Qualified Retirement Plans is one of the most complex problems facing someone doing estate planning.

To begin with, planning for distributions of retirement benefits must be faced at least three different times: (1) before the participant retires with regard to the designation of beneficiary and the form of payment (although this later decision usually will be subject to change before the participant actually retires); (2) at retirement; and, finally, (3) after death of the participant. Each time the individual's objectives are likely to be different, bringing into play different tax rules. In addition, it is important for the retirement plan participant to review his or her planning with respect to these distributions at other times, certainly when the participant approaches minimum distribution age or 70° and when accrued benefits under the plan approach the threshold for taxes on excess lump sum distributions, etc.

For persons who are considering making charitable gifts as a part of their planning, one simple concept can be the key to avoiding substantial taxes and increasing the share or benefits passing to the estate owner's beneficiaries. That simple concept is this: **Since charities do not pay income tax on income they receive, using tax qualified retirement benefits to make charitable gifts avoids both income tax and transfer tax on those accumulations allowing greater amounts of other assets to pass to other beneficiaries after death.** Substantial taxes can be saved by simply allocating retirement benefits to charitable beneficiaries and using other assets to provide for heirs.

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"YOU CAN MAKE A LARGER GIFT TO CHARITY USING QUALIFIED RETIREMENT BENEFITS WITHOUT ADVERSELY AFFECTING THE AMOUNT PASSING TO YOUR HEIRS THAN IF THE CHARITY WERE GIVEN OTHER ASSETS."

Put another way, you can make a larger gift to charity using qualified retirement benefits without adversely affecting the amount passing to your heirs than if the charity were given other assets. And that is just for starters!

You don't have to give all of the benefit from the retirement accumulations to charity to make this work. You can also arrange for the post death benefit to be paid to a Charitable Remainder Trust (CRT), with a partial charitable deduction for estate tax purposes and avoidance of the income tax upon distributions from the Plan or IRA. This allows beneficiaries to receive distributions for life or a term of years from the CRT. True, distributions from the CRT may be taxable to the beneficiaries, but remember, the entire amount passing to the CRT, undiminished by income taxes at death, are available to provide the income stream for your beneficiaries. Compare this result with an outright gift of the retirement accumulations to your beneficiary and investment of the proceeds after income and estate taxes (that can be as high as in excess of 80 percent when combined).

Who should take advantage of these planning tools?
Married persons can pass retirement benefits to the surviving spouse, under the marital deduction, free of estate tax. Then, with proper planning, the surviving spouse can often spread distributions (and the taxes thereon) over prolonged periods measured by the life expectancy of the surviving spouse and usually younger beneficiaries. Deferring the distribution through election of an installment method allows the continued investment of retirement funds in the tax sheltered environment provided by the Plan or IRA. Deferring the distributions is almost always better from the standpoint of continued growth of the benefits and minimizing taxes.

Neither a surviving spouse nor an unmarried person can take advantage of the marital deduction. Only the surviving spouse (but not other beneficiaries) has the right to roll distributions into their own IRA and this device will not be available at the surviving spouse's death. Thus a surviving spouse or an unmarried person is ideally suited to use these planning tools.

Others may find that one or both of these concepts meet their planning goals as well. For instance, a retiree may want to reduce the amount that would be distributed under the Required Minimum Distribution rules after his or her death. This can be accomplished by naming an individual as the beneficiary and a CRT as the successor beneficiary. If the individual beneficiary disclaims his or her interest, the funds can flow to the CRT (of which the individual may be a lifetime beneficiary or one of the beneficiaries) so that distributions are extended over a potentially longer period.

For retirees with substantial qualified retirement benefits in their potential estates, use of those assets to make contributions to charity, such as the **Community Foundation**, is very attractive and can provide significant tax savings for the retiree and his or her beneficiaries. The rules are complicated, however, and planning should be done with care.

For more information on giving to the Oklahoma City Community Foundation, contact Nancy Anthony, Executive Director, at 405/235-5603.