Donating Retirement Assets to Charity

Retirement assets—IRAs, employer-sponsored 401(k)s, profit-sharing plans, and 403(b)s to name a few—are an important and often overlooked part of estate planning. Designating a charity as beneficiary of all or part of your retirement assets can be a highly tax-efficient strategy, for reasons that we will discuss.

Sitting down with your financial advisers and doing a thorough review of your situation should always be the first step in estate planning. It may well turn out that it makes sense for your spouse and/or children to be the beneficiaries of your retirement assets. But if you are interested in gift/bequest to charity, consider using your retirement assets to fund that gift.

Why? As you likely know, most retirement plans offer special tax-deferred status: that is, the assets accumulated in the plan are not taxed until they are distributed or withdrawn. After your death, withdrawals from these plans are characterized as "income in respect of a decedent" (or IRD), a technical phrase meaning income that was not taxed before death. Thus someone—typically the person withdrawing the money—must ultimately pay income tax on it. And your retirement assets will be includable in your estate, with the result that estate taxes may be payable as well, depending upon the level of "estate-tax exemption" in effect at the time.

But—and here comes the cavalry—a tax-exempt charity can receive funds from an IRA or other retirement plan without paying tax on that distribution. Furthermore, your estate, in the event it is burdened with estate taxes, can take a charitable deduction for the amount left to charity. Thus, retirement assets can pass to the charity in a tax-efficient way, free of income and estate taxes. For gifts to your family, you can make use of other investment assets. These may be subject to estate tax but will not engender any immediate income tax liability (only capital gains when ultimately sold).

If you are thinking of taking advantage of this strategy, make sure you get the mechanics right. Just because you have executed a will, it does not mean that you've done an effective job of naming a beneficiary. IRAs and other retirement assets should not pass via your will but, rather, they should pass to the charity named as your beneficiary on the "beneficiary designation form" specifically used for that plan. It is also a good idea to make the charity a 100 percent beneficiary of the retirement plan, but if you don't want the whole plan to go to charity, carve out the desired charitable portion and put it in a separate IRA.

If you are wondering what happens if you forget to fill out that designation form, the answer is that your retirement assets would be distributed according to your will (if you have one). At first blush that may seem OK, but it's really not because your retirement assets would then be subject to the delays of probate administration and to the claims of creditors. Plus, important tax-deferral opportunities, otherwise available to family beneficiaries, are lost.

Please consider making Cato a beneficiary of your retirement assets—it's tax efficient for you and a splendid contribution for us.

For more information about this or other gifting topics, please contact Cato's director of planned giving, Gayllis Ward, at 202-218-4631 or at gward@cato.org. ■