MAKING YOUR DOLLARS MAKE SENSE

TIPS FOR HELPING YOU GET THE MOST OUT OF YOUR CHARITABLE GIFTS

RETIREMENT ACCOUNTS AND THE ESTATE TAX

BY JEANNE POTTER, CPA

MANY PEOPLE AREN'T AWARE that the assets in their retirement accounts may be taxable at death. The good news is that changing beneficiaries may help eliminate some or all of those taxes. *(Note: For the purpose of this article, we are referring to retirement accounts that are funded with pre-tax dollars; that excludes Roth IRAs.)*

In general, Congress allows estates valued below a certain dollar amount to pass to heirs free of estate and income taxes after death (generally referred to as a lifetime exclusion). As of this writing, the specific amount hasn't been set for the years 2010 and beyond.

Many people incorrectly assume the value of their retirement account can be added to the value of other assets and, if the total is less than the lifetime exclusion, it will pass to heirs tax-free. Although some people assume their retirement accounts are treated similarly to other assets in their estate, they are not.

It makes sense. When you make a contribution to a non-Roth IRA retirement account, you don't pay taxes on the contribution. Effectively, you reduce your taxable income for that year.

The catch is that the taxes are deferred, not waived. Taxes are due at the time the funds are distributed from the retirement account. That may be when someone retires and withdraws the funds for living expenses, or after death, when the funds are withdrawn by his or her heirs.

In the latter case, federal income and estate taxes, if applicable, can erode up to 70 percent of the assets in those retirement accounts.

There is good news, though. For those who want to include charitable giving in their estate planning, changing the beneficiary on a retirement account can eliminate some or all of those taxes, ensuring that more of your money goes to the people and institutions you care about.

Designating a qualified charity – such as Cal Poly – as your retirement account beneficiary eliminates both estate and income taxes on the portion of the retirement account assets bequeathed to the charity. To illustrate, let's look at a simple example with estimated estate and income tax rates applied:

BENEFICIARY	NON-CHARITABLE HEIR	CAL POLY
IRA VALUE AT DEATH	$ 1,000,000	$ 1,000,000
ESTATE TAX (45 PERCENT)	$ 450,000	N/A
NET AFTER ESTATE TAX	$ 550,000	$ 1,000,000
INCOME TAX (44.55)*	$ 245,025	N/A
NET BENEFIT	$ 304,975	$ 1,000,000

*COMBINED FEDERAL & CA RATES

If a charitable donation appeals to you, there are some important things to consider. For instance, it's important to establish the funds destined for the charity in a retirement account that is distinctly separate from any retirement account designated for other heirs. Each retirement account must be distributed within a certain interval after death. That interval is based on the life-expectancy of the heirs on that particular account.

But charities have zero life expectancy, according to the IRS. If the charitable gifts are in the same account as the funds designated for other heirs, the arrangement can force other beneficiaries to liquidate assets sooner than may be optimal. Separating the funds into different accounts avoids that complication.

Or, if you have a mix of assets and other non-retirement assets, you may consider giving the assets in the retirement account to Cal Poly and bequeathing the non-retirement assets to your heirs. Non-retirement assets may not face the same tax liability. Your heirs may be eligible for a step-up in basis on the non-retirement assets, which means they are likely to benefit from a tax savings when they do eventually divest themselves of the asset.

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Before making any changes, it's important to consult with your tax adviser and the planned giving officers at Cal Poly to determine the optimal strategy for your particular situation. For more information, contact the Planned Giving Department at (805) 756-7125 or plannedgiving@calpoly.edu. □

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AT YEAR END, THINK ABOUT WHERE IT ALL BEGAN

"I owe where I am to the education Cal Poly gave me."
–Mike Avella, Civil Engineering, 1980

* Courtesy of University Archives, Cal Poly.

AS THE END OF THE YEAR APPROACHES, many pause to review, reflect, and plan. Thoughtfully addressing your charitable giving priorities between now and December 31 can help assure maximum benefits for you and your charitable interests. We hope you will consider including Cal Poly in your year-end giving plans.

To make a gift in 2010, please consider the following options:

GIFTS OF CASH Donations must be postmarked on or before December 31.

ONLINE GIVING You may visit www.giving.calpoly.edu to make a gift using your credit card on our secure online giving site.

STOCK DONATION By making a gift of appreciated assets, you may be able to take advantage of your gift's full fair market value without paying capital gains.

BEQUEST Toward the end of each year, many people also review their long-range estate and financial plans.

For more information about these giving options, contact:

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