

CHRISTIAN MONEY \$ENSE

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Estate Planning 301- Your Retirement Plan Is Going To Uncle Sam

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It is no secret that the stock market has been hit hard the last few years. This has caused many people's qualified retirement plans (401k, IRA) to decrease significantly. Every major financial magazine has articles on reallocating your portfolio. No one likes to lose money.

A Problem

The stock market will come back. On average, stocks return about 8% per year. But, a downturn in the stock market is not the biggest threat you will face on your 401k or regular IRA. There is a little-known rule in the IRS code that will reduce your retirement account by about 50% upon your death. This is called the "income with respect to decedent" (IRD).

A 401k or a regular IRA are wonderful vehicles to save for retirement, but they are horrible for passing wealth to your family upon your death. With a 401k or regular IRA, you invest money today (reducing your income taxes), let your funds grow tax-free, and only pay income taxes when you withdraw your funds at retirement.

The rule that forces you to pay taxes when you withdraw funds at retirement is the same rule that forces your heirs to pay taxes on your retirement account when they inherit it from you. Our income tax structure is a graduated system. The more you earn, the higher your tax rate.

An Example

Your child earns a \$40,000 salary. You die and leave a \$100,000 regular IRA to her and she decides to withdraw all of the money at one time. Per the IRS code, your child has earned \$140,000 that year and is taxed at a higher income tax rate (30% for 2003). When you also add the state income taxes and possible federal estate taxes, it is very likely that your family will lose 50% of the value of your retirement account in taxes.

Is that really what you want?

Let me offer a few warnings.

- First, IRD does not apply when you leave your retirement account to your spouse. He or she can roll your retirement account into theirs and pay taxes on the combined amounts when withdrawn.
- Second, if you have a Roth IRA, IRD is not an issue since money withdrawn from that vehicle is income tax-free.
- Third, your family is not required to withdraw 100% of the funds at one time. They can spread the payments out over time. However, I would suspect that your family will withdraw funds as quickly as possible, not realizing the tax implications.

A Solution

Create a Charitable Remainder Unitrust (CRUT) that is funded by your retirement account at your death. Charities do not pay taxes, so your CRUT will not pay income taxes according to the IRD rule. The CRUT would be set up to pay an income to your family for a period of years and then distribute the remaining funds to the ministries of your choice. Your family wins, and the Lord's work wins. You are able to give your retirement account twice (to family and ministry) with eternal returns on your investment.

BBC Foundation specializes on these types of trusts. Next week, we will discuss them more fully.

BBC Foundation has been ministering to churches and individuals regarding biblical stewardship since 1992. Send your questions on finances and stewardship to: BBC Foundation, 538 Venard Rd., Clarks Summit, PA 18411. Phone: (800) 451-8668, website: bbcfoundation.org; e-mail: info@bbcfoundation.org