

# IRAs AND TAXES



**MOODY STEWARDSHIP**  
A Ministry of Moody Bible Institute

# IRAs and Other Qualified Retirement Plans

IRAs, pensions, and estate planning are all excellent resources for preparing an enjoyable, financially worry-free retirement. But without taking into consideration the effect of taxes on your retirement plans, achieving the comfortable lifestyle you desire can be filled with unwelcome surprises.

If you want to make the most of your retirement savings, Moody Bible Institute Planned Giving can help. We've prepared this brochure to help you learn more about how to reduce taxes, benefit you and your family, and help advance the cause of Christ through the ministries of Moody.

## Individual Retirement Accounts – IRAs

A tax deferred IRA is a valuable retirement planning tool. You are eligible to establish an IRA account, even if you are participating in a company pension plan. Earnings accumulated in the account will not be taxed until you withdraw them – usually at a later time when your tax rate is lower. It should be noted that Roth IRAs do not have the income tax implications during life or at death that are discussed in this brochure.

### **Lump Sum Distribution vs. Direct Deposit to an IRA**

If lump sum distribution from a qualified pension plan is an option for you, be aware of the tax withholding requirement. When requesting a lump sum distribution, 20% will be withheld for taxes. You will have 60 days from the date of distribution to make a tax-free rollover into an IRA account; however the 20% will be withheld for taxes. You will have 60 days from the date of distribution to

make a tax-free rollover into an IRA account; however the 20% withholding tax will not be refunded, because this method of distribution allows the government to have interest-free use of your money. You may wish to consider the following alternative:

### **Direct Deposit of Qualified Plan to IRA**

To avoid the 20% withholding tax, you may have distributions placed directly into a qualified IRA account. It is recommended that you establish a separate IRA for this purpose rather than combining your distribution with money you already have in an IRA.

### **Taxation of IRA Distributions**

Most often, IRA withdrawals are taxed as ordinary income. If you are less than 59 years old, you can expect a 10% penalty tax in addition to the regular tax. If you are between 59 and 70, your funds will be taxed as ordinary income. After you reach age 70 1/2, distributions are required based upon your life expectancy. If you are married, it can be based on the life expectancy of you and your spouse. In either instance, your IRA withdrawals will continue to be taxed as ordinary income.

At the death of the owner of the IRA, and/or the surviving spouse, any remaining IRA proceeds will become taxable income to the heirs of the estate. By using these proceeds to provide support for a charitable organization, such as Moody Bible Institute, this income tax can be eliminated, and you can enjoy the satisfaction of knowing your partnership with Moody will endure for many years.

The IRS has issued new regulations concerning minimum distributions from IRA and other retirement accounts. Under the new regulations, all IRA

holders will be able to use a two-life calculation for minimum distribution purposes, and, in most cases, the “beneficiary” will be treated as being 10 years younger than the account holder.

These new regulations make it even more attractive to name a charity or a charitable trust as beneficiary of a retirement account. The account holder is entitled to use a two-life calculation even if a charity, trust, or other “non-individual” is named as beneficiary.

## The IRD Tax Problem

Few people realize that at the death of the owner of an IRA and/or the surviving spouse, funds remaining in the account become taxable income to the heirs of the estate.

### **Income in Respect of a Decedent (IRD)**

*What does it mean?*

The term Income in Respect of a Decedent refers to ordinary income items which are included in a deceased person’s estate, but have not been included on his/her final income tax return. IRD items usually pass to the estate unexpectedly, with the unforeseen tax liabilities seldom being included in the estate planning process. Common examples of IRDs are IRAs and qualified pension plan distributions, deferred gain on commercial annuities, and interest accrued on U.S. Savings Bonds (Series EE & HH). Fortunately, IRD tax liabilities can be avoided by naming a charitable organization, such as Moody Bible Institute, as beneficiary.

A donor may designate Moody Bible Institute as beneficiary of an IRD asset at the donor’s death. Because of Moody’s tax-exempt status, the income tax on this asset will be avoided. Estate taxes can also be avoided, since this gift would be eligible

for the federal estate tax charitable deduction. It should be noted that to avoid the income tax the asset must pass to charity at the death of the donor. A lifetime transfer will result in the income being taxed to the donor at the time of the gift to charity.

There are solutions to the IRD tax problem that reduce taxes and provide significant benefits to heirs.

**Case Example 1 (Problem)** Taxable estate with tax consequences in 2004 and 2005

*Single estate owner, no charitable gift*

\$2,000,000 Total estate, \$800,000 is IRA

\$225,000	Federal Estate Tax on total estate
\$184,000	Potential Federal Income Tax
<u>          </u>	from IRD on IRA
\$409,000	Total potential taxes due on estate
\$1,591,000	Amount to children or heirs
\$ 0	Amount to charity

**Case Example 1 (Solution)** \$800,000 IRA to charitable remainder unitrust at estate owner's death to pay income to heirs for twenty years

\$92,591	Federal Estate Tax on total estate
\$ 0	Federal Income Tax from IRD
<u>          </u>	on IRA
\$92,591	Total taxes due on estate
\$800,000	Income to children or heirs over
	20 years
\$1,107,409	Outright to children or heirs
\$800,000	Amount to charity

Total taxes on estate have been significantly reduced. Amount to children is increased, but part is in form of income rather than outright.

*In order for the tax on IRD to be avoided, the charitable gift must be properly structured. We recommend consulting a professional advisor to be certain your gift is handled properly.*

Following are examples of problems IRD items can create and some possible solutions:

- At the time of death, a decedent owned an IRA valued at \$500,000. The estate received distribution of the IRA. The decedent's estate incurred an income tax liability of about \$150,000. If it is not taxed to the estate, it will be taxed to the heir/beneficiary of the IRA.
- The decedent owned a commercial annuity. The annuity payments continued to a named beneficiary. The value of the annuity was included in the estate. The heir/beneficiary will incur income taxes on any gain above the decedent's contribution or premiums paid.
- A widow owns \$100,000 of Series EE bonds that will be left to her son. She paid \$25,000 for the bonds, which means \$75,000 will be income in respect of a decedent, which will be taxable to her son. The income tax would be about \$22,000. If she left the bonds to Moody at her death to fund a gift annuity or other life income plan for her son, the income tax would be avoided.

An outright charitable gift of an IRA, commercial annuity, or Series EE bonds at death will eliminate the income in respect of a decedent problem. The

IRD tax problem will affect both estates that are taxable for federal estate taxes and estates that are non-taxable for estate tax purposes.

The gift of an IRD asset to charity is a very cost effective method to make a charitable gift. The following illustrates a low cost gift.

**Case Example 2 (Problem)** 2004 or later

*Single estate owner, no charitable gift*

\$1,000,000 Total estate, \$200,000 is IRA

\$ 0	Federal Estate Tax on estate
\$40,000	Possible Federal Income Tax from IRD on IRA
_____	
\$40,000	Total potential taxes due on estate

**Case Example 2 (Solution)**

*Single estate owner*

\$200,000 charitable gift of IRA at death

\$ 0	Federal Estate Tax on estate
\$ 0	Federal Income Tax from IRD on IRA
_____	
\$ 0	Total taxes due on estate

As you can see, the tax savings are \$72,000 from a \$200,000 charitable gift.

## Avoiding the Tax Trap

To find out more about how you can avoid tax liabilities, contact the Stewardship Department at Moody Bible Institute by calling us, toll-free, at 1-800-DLMOODY. Our trained representatives are available to assist you in making tax-wise decisions for today and tomorrow.



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