JUNE 2014 NEWSLETTER

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WHY RETIREMENT FUNDS ARE THE ASSET OF CHOICE FOR CHARITABLE GIFTS AT DEATH

FIRM ANNOUNCEMENTS:

Pozzuolo Rodden, P.C. are pleased to announce that Kelly Barse, Esquire has joined the Firm as an associate. Ms. Barse has a Masters of Law (LL.M) in taxation, and an Estate Planning Certificate from Temple University Beasley School of Law and received her Juris Doctorate from Rutgers School of Law. Ms. Barse will be concentrating in the estate planning and estate administration areas at the firm.

SEMINARS:

Judith P. Rodden, Esquire and Lesley M. Ibanez, Esquire will be presenting a CPE/CLE at *Penn State Doylestown Campus* on **Thursday June 19, 2014** from

12:30pm-4:30pm.
The Topic will be "*Commercial and Residential Real Estate Practice Today: From Agreement of Sale to Closing, with Ethics*".
Please contact Theresa M. Bloom, Education Program Manager to sign up.
Call 215-881-7402 or email: tmb17@psu.edu

QUESTION OF THE MONTH:

SHOULD A 75 YEAR OLD WIDOW JOINTLY TITLE HER SAVINGS ACCOUNT WITH HER SON TO ENSURE HER BILLS ARE PAID?

Answer-See Page 4 of this Newsletter

WHY RETIREMENT FUNDS ARE THE ASSET OF CHOICE FOR CHARITABLE GIFTS AT DEATH

If you are planning to make a bequest to a charity in your will, you may want to instead consider making a gift of a retirement account to maximize the tax benefits for both your estate and your individual beneficiaries. In 2014, estates with gross assets in excess of $5,340,000 must file a federal estate tax return and estate tax may be due on assets included in the estate in excess of that amount. Currently, any assets over $5,340,000 that are transferred from a decedent's taxable estate are taxed at a rate of 40%. While this may seem like a steep tax rate, the individuals to whom the property is transferred do not have to pay income tax on what they receive.

The exception to this rule is for accounts such as traditional qualified retirement plans, IRAs or 401(k)s. The distributions from a traditional qualified retirement plan, IRA or 401(k) are classified as income in respect of a decedent (IRD). Distributions from these accounts are taxed as ordinary income as the government has not already taxed this money. This income is added to the beneficiary's income from other sources and then taxed at the beneficiary's applicable marginal income tax rate as ordinary income. If the individual has significant income from other sources or if the distributions from the retirement account are very large, it could result in your retirement account effectively being taxed at a rate in excess of 60%, for federal and state estate and income taxes. Making a charitable bequest of a retirement account instead of leaving it to an individual beneficiary can greatly reduce both federal and state estate and income taxes.

Gifts of property to charities are not subject to the federal estate tax and are excluded from a decedent's taxable estate. Under Section 2055 of the Internal Revenue Code, a deduction is permitted on the federal estate tax return for gifts made to charities, government agencies, certain fraternal societies, and/or certain veterans' organizations. The amount of the charitable

contribution can be deducted on the federal estate tax return to reduce your net estate to an amount closer to or under $5,340,000, so that less or no federal estate tax is due.

Income taxes can also be reduced because charities do not have to pay income tax on the distributions from retirement accounts. For individuals, required minimum distributions must be taken from a retirement account by April 1st following the year when an account holder reaches the age of 70.5. Depending on how the individual beneficiary was related to the decedent who owned the account and how the account passes to a beneficiary, a retirement account may have to be distributed in as few as five years, resulting in more income tax due sooner. Every distribution from the retirement account will trigger additional income tax liability if the distributions are made to an individual beneficiary. By designating a charity as the beneficiary of the retirement account, the entire amount of the account will be received by the charity instead of the government taking in excess of 60% of the account to pay federal and state estate and income taxes.

Even if your estate will not owe any federal estate tax, it is still best to make all charitable bequests using retirement accounts because it will result in the least total federal and state income tax liability for your individual beneficiaries. If you are intending to make charitable requests at your death, gifting the retirement account, or a portion thereof, to a charity, allows you to give other assets to your individual beneficiaries, such as real property or investment accounts, which will not cause them to incur additional income tax liability.

How to Make a Charitable Bequest of a Retirement Account

In order to make a charitable bequest of your retirement account, you must name the charity as a beneficiary on the beneficiary designation form for the account. This form can be obtained from the administrator for the retirement account. One advantage of naming the charity on the beneficiary designation form is that you have the option to leave all or a percentage to the charity, or multiple charities, and/or and the remaining amount to other beneficiaries, such as family and friends. It is important to note that your will does not govern how the funds in the retirement account will be distributed unless you name your estate as the beneficiary of the retirement account.

However, one problem that could arise by naming the estate as beneficiary is that your executor could make the mistake of cashing out the entirety of the retirement account to distribute part to the charity and part to the individual beneficiaries, resulting in significant, additional, unnecessary income taxes due from the estate and/or individual beneficiaries. Additionally, naming your estate as the beneficiary of the retirement account is inadvisable if you plan on leaving any portion of the retirement account to an individual as this can affect the number of years the individual beneficiary is required to take distributions from the retirement account, which could result in an increase in income taxes. Naming the charity as a direct sole beneficiary on the account's beneficiary designation forms is the best way to ensure favorable tax treatment.

Charitable Remainder Trusts And Qualified Disclaimers

In the event you do not want to immediately transfer your retirement account to a charity, you could designate the charity as a beneficiary of a charitable remainder trust. In this case, the

trust will be treated as subject accelerated distributions from the retirement account following the account owner's death. This, however, should not matter because the charitable remainder trust is exempt from income taxation. Instead, the trust beneficiary, such as spouse, will recognize taxable income as she receives the unitrust (a percentage of trust assets) or annuity (a fixed payment each year) payments from the trust.

You could give your spouse the option of disclaiming all or a portion of the account and having the disclaimed assets pass to a charitable remainder trust, wherein your spouse is named as the primary beneficiary and the charity of your choice is named as the remainder beneficiary. This option gives your spouse the flexibility to determine how much income she needs at that time to ensure she can live comfortably while still benefiting the charity at a later time. This option is only available for spouses; children and other individuals cannot be beneficiaries of the charitable remainder trust if they made a qualified disclaimer of the account.

Private Foundations

Finally, gifting the retirement account to a private foundation provides the same tax benefits as an outright gift to a charity with the added benefits of more control over how the funds are used and the possibility of more family involvement by appointing family members as Trustees of the foundation. Use of a private foundation allows the donor to ensure that the money is being put to the best use by any number of charities and can help ensure that the donor's wishes are being carried out even years after his passing. It can also teach your children the value of philanthropy and money management skills if they are Trustees of the foundation.

If you are contemplating making a gift to a charity after your death and have any questions or concerns regarding how to best include such a request in your estate plan, please do not hesitate to contact us and set up an appointment. Beneficiaries who understand the severity of the taxes may decide that it is more worthwhile to let the assets pass to a charity rather than allowing the government to take a large chunk of the assets.

QUESTION OF THE MONTH:

SHOULD A 75 YEAR OLD WIDOW JOINTLY TITLE HER SAVINGS ACCOUNT WITH HER SON TO ENSURE HER BILLS ARE PAID?

We do not recommend adding the widow's son as a joint owner of her savings account to ensure her bills are paid.

If she plans on adding her son as a joint owner of the account only for the sake of convenience to pay her bills, then a durable power of attorney would be more appropriate. This would allow her son to access her account to pay her bills even if she is not capable of doing so herself in the future. A power of attorney that provides restrictions on her son's ability to make gifts would also ensure that her son does not have the right to give the money to himself. Finally, as a fiduciary, her son would be held to the highest standard of loyalty and could be held accountable for any misuse of his mother's funds.

Under Pennsylvania law, if she adds her son as a joint owner of the account, he would be entitled to the entirety of the funds remaining in the account upon her passing. In Pennsylvania, a joint account in a bank or other financial institution is governed by the Multiple-Party Accounts Act. A "joint account" is defined as "an account payable on request to one or more of two or more parties whether or not mention is made of any right of survivorship." By naming her son as a joint owner of the account, the widow would be giving her son the right to withdraw the funds in the account whenever he so chooses, even if not for her bills.

The Act further provides that when one of the parties to the account dies, the surviving party is entitled to any sum remaining on deposit even if the decedent's will provides for a different distribution. This presumption can only be rebutted if there is clear and convincing evidence of a different intent at the time the account is created. Jointly titling her savings account with her son may conflict with the widow's current estate plan if she plans to provide for her other children equally under her will. This is especially so if the savings account constitutes a significant portion of her estate.

Additionally, if she adds her son to the account as a joint owner, her son's creditors could levy on the account to pay his bills or, if the son gets divorced while he is a joint owner, the son's spouse could claim that she has rights to some of the funds in the account. This could have the effect of depriving the widow of the use of the funds if she is forced to go to court to show that the account was only re-titled for convenience and not as a gift.

Further problems could arise in the event the widow is predeceased by her son. In that event a joint bank account is taxable for Pennsylvania Inheritance Tax purposes even if the son's name was added to the account as a matter of "convenience". The mother as a lineal beneficiary would be taxed in Pennsylvania at a taxable rate of 4.5% on one-half (1/2) of the value of her own account at her son's death. By executing a power of attorney instead of jointly titling the savings account, the account is not taxable for inheritance tax purposes should the son predecease his mother.

- If there are any legal questions you would like this office to answer in the future, please email the question to us at info@pozzuolo.com. Each month, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, corporate law, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning, estate administration, tax and pension law, family law litigation.

PUBLICATIONS

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: http://pozzuolo.com/Pubs Articles.shtml

Corporate/Tax Articles

- Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business
- Deferred Compensation Rewards And Retains Key Employees
- Design Buy-Sell Agreements For Maximum Utility
- How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend

- How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations
- How To Look, Act And Sound Like A Professional Corporation
- How to Structure a Suitable Buy-Sell Agreement
- How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool
- Money Purchase Pension Plan Falls Out Of Favor
- Protecting A Client's Business From Unfair Competition Using Restrictive Covenants
- Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules
- What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs
- Why An Employment Contract Is Mandatory

Estate Planning Articles

- Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples
- College Funding Tool Offers Estate Planning Advantage
- Diversify Strategies For An Effective Estate Plan
- Divorce and Estate Planning
- Divorce Raises The Need For Performing An Estate Planning Review
- Drafting The Durable Power Of Attorney For Wealth Protection Purposes
- Estate Planning For Pet Owners
- Remarriage Situations Can Raise Special Estate Planning Considerations
- Six Proven Estate Planning Techniques
- Special Needs Trust - An Estate Planning Tool For The Disabled
- The Limited Liability Company -A Sophisticated Tool For Estate Planning
- Using Trusts To Maximize Family Protection And Minimize Estate Tax
- Why Living Wills- Advance Directives Are An Essential Part Of Estate Planning

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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