Prepared for the Benefit of the
Friends of Bluefield College

Introduction to Estate Planning

Americans are living longer and healthier lives and thoughts about our “golden years” are changing. Retirement is no longer a short stretch at the end of a long working life. Retirement is an opportunity, a new phase, a time to do those things you’ve always wanted to do, and an opportunity to redefine and refine your priorities. Consider that a retirement that begins at age 65 can easily be fifteen to twenty-plus years in length.

According to the Social Security Administration (life expectancy table), a 65-year-old man will live an *average* of more than 17 ½ years, and a 65 year-old woman will live an *average* Many financial experts believe we need to replace at least 70% of pre-retirement income to maintain our lifestyles after we stop working. That means we need to re-think how we save for retirement, how we convert those savings into income-producing assets, and how we spend during retirement.

Most people contemplating retirement understand that Social Security benefits may not be a reliable or a sufficient source of retirement income. Social Security offers an income base, but Social Security income alone will not provide a fully-funded retirement program. Therefore, it is important to heed the advice of investment experts to save ten percent (or more) of earnings and take full advantage of tax-deferred retirement opportunities. The key to a comfortable retirement for most people is using tax-advantaged savings plans to significantly supplement Social Security income.

Employed persons may have access to a qualified retirement plan provided by their employer. Many also take advantage of Individual Retirement Accounts (IRA's), personal retirement funds for people who have earned income. There are two types of IRAs. The first type is the traditional IRA, which allows both deductible and non-deductible contributions. In either case, all earnings accrue tax-deferred, but upon withdrawal will be taxed as ordinary income. Secondly, there is the Roth IRA, in which contributions are not tax deductible but "qualified" withdrawals from the account, including earnings, are not taxable. Annual contribution limits for both types are currently $5,500 per year ($6,500 for individuals age 50 or older).

A Keogh plan is an excellent retirement vehicle for self-employed persons. For those who are not self-employed (and therefore, cannot set up a Keogh plan), an alternate choice may be your employer's 401(k) or 403(b) plan. These are retirement savings plans that allow the employee to make pretax deductible contributions that grow on a tax-deferred basis.

Retirement planning begins with informed calculation and incorporates aspects of income needed, Social Security benefits, pension benefits, and other savings and investment. Visit the following Social Security Administration website to access several retirement resources, including planning calculator options: http://www.ssa.gov/retire2/.

Charitable Planning Options

Four ideas that combine retirement funding with charitable giving are: 1) donations through IRA contributions, 2) the bequest of all or part of your retirement plan to a non-profit organization, 3) the deferred payment gift annuity, and 4) the charitable remainder unitrust.

IRA Charitable Rollover

The IRA Charitable Rollover has been made permanent with the recent tax law change. If you are 70 ½ or older, you are required to take a minimum IRA distribution. Normally, these distributions are subject to income taxes. However, for persons aged 70 ½ and older, the IRA Charitable Rollover provision allows you to transfer up to $100,000 to charitable organizations each year directly from your IRA, without treating the distribution as taxable income. In order to qualify, contributions must go directly from your IRA to a

public charity and be made from traditional IRAs or Roth IRAs. Donors may receive no goods or services in return for their contributions and must obtain written documentation of their contribution from each recipient charity.

If you took the mandatory distribution from your IRA, it would trigger a tax burden. This is true even if you subsequently donated the distribution you received to a charity. To avoid tax, designate that the charity receives the distribution directly from your IRA. If you have a gift you would like to make, or a pledge payment to fulfill, consider funding that gift with a non-taxable distribution from your IRA.

Bequeath Retirement Plans to Charity

For retired persons with the bulk of their assets in individual retirement accounts, corporate or partnership pension plans, or profit-sharing plan accounts, there is another option. Significant advantages exist in giving or bequeathing funds to charitable institutions such as Bluefield College from your retirement assets.
Charitable bequests can be funded with retirement funds by naming Bluefield College as a beneficiary.

A. The disposition of IRA's, pension, and profit-sharing plans is not governed by a person's will, but rather by beneficiary designation forms provided by the plan itself. The participant designates on the beneficiary form who she or he wishes to receive the retirement benefits which remain after death. In the absence of a designation, the primary beneficiary is governed by the plan's terms. A nonprofit organization such as Bluefield College can be named as beneficiary, with the non-participant spouse's consent. (Spousal consent is not required for an IRA, except in some states.) The designation could take several forms:

   - As secondary beneficiary (for example, one's spouse is named primary beneficiary to receive retirement benefits for his or her life, then the institution would receive payments of those benefits, but with the surviving spouse free to change the secondary beneficiary).
   - As contingent beneficiary (meaning that the institution would receive the benefits if the employee's spouse predeceases him or her).

   - Bluefield College could be named as beneficiary for full benefits, for a fraction of the account or for a stated cash amount.
   - If the person is survived by descendants, the designation could be to the surviving spouse first for his or her life and thereafter the balance in the account is divided

between Bluefield College and those descendants, as well as any other charities the participant desires.

B. There are distinct tax savings in making testamentary charitable gifts using retirement assets compared to probate assets. Unlike other assets, retirement funds are subject to income tax when distributed, unless the funds are paid to tax-exempt charities. Accordingly, a good way to fund a charitable bequest at your death is by means of your retirement plan. If you are 70½ or older, naming a charity as the beneficiary of your retirement plan generally will not accelerate the required minimum yearly distributions to you during your life. At death, if persons other than the surviving spouse or tax-exempt charities are beneficiaries of your retirement funds, these funds are also potentially subject to estate taxes. <u>Under current estate and income tax rates, if your personal estate is worth more than $11,400,000, the total estate and income taxes on retirement plan assets can reduce the value received by heirs to 40 cents on the dollar or less</u>.

C. Much of an individual's other assets, such as real estate, taxable investments, and business ownership are not subject to income taxes when distributed. Thus, if you have decided to leave some of your assets to charity upon death, charitable bequests funded with retirement accounts minimize taxes and enable you to pass assets to Bluefield College without a prohibitive cost to your heirs relative to the after-tax assets they otherwise would receive.

If you have an IRA, pension and/or profit-sharing plan account balance and you are considering naming Bluefield College as a beneficiary, be sure to consult a lawyer or other tax advisor to properly execute that designation.

<u>The Deferred Payment Charitable Gift Annuity</u>

A deferred payment charitable gift annuity offers an attractive way to make a gift to Bluefield College <u>now</u> while guaranteeing personal annual income when you retire or at another time of your choosing. If you need tax deductions during your peak earning years and supplemental income when you retire, the deferred payment gift annuity could be a strong option for you. A deferred payment gift annuity would allow you to receive a current income tax deduction for the value of the gift minus the value of your future annuity payments. The following example should provide a clearer picture of this opportunity.

Example:

Consider the hypothetical example involving Jennifer Lynn, a 55-year-old accomplished sales executive and supporter of Bluefield College. She is looking ahead to retirement and wants to

make certain that she has sufficient annual income at the time she retires from her company. To supplement her taxable investments, Jennifer has decided that a deferred payment gift annuity would accomplish two of her primary objectives: to assist Bluefield College and to provide retirement income for herself. Jennifer is in the 32% income tax bracket.

For purposes of this illustration, we will assume that Jennifer currently does not need the income that could be produced by a traditional investment of $50,000 and uses that amount to purchase a deferred payment gift annuity. Further, she decides that she wants to begin receiving annual income from the annuity when she reaches age 68, by which time she plans to retire. During this 13-year period, when Jennifer does not receive income, the investment accumulates in value on a tax-deferred basis. Then, at age 68, when Jennifer begins receiving income from the deferred payment gift annuity, a portion of it will be tax-free.

THE APPROXIMATE RESULTS OF THIS TRANSACTION ARE SUMMARIZED AS FOLLOWS:

1.	PRINCIPAL AMOUNT FOR DEFERRED PAYMENT GIFT ANNUITY	$50,000
2.	NUMBER OF YEARS PAYMENT IS TO BE DEFERRED	13
3.	ANNUITY RATE	8.2%
4.	ANNUAL ANNUITY PAYMENTS BEGINNING IN 2032	$4,100
5.	AMOUNT OF ANNUAL ANNUITY PAYMENT EXCLUDED FROM TAXES	$1,566
6.	TAX DEDUCTION IN YEAR OF GIFT	$21,988
7.	CURRENT YEAR TAX SAVINGS AT 32%	$7,036

***Note that this illustration assumes a rate of return that may not be applicable when an actual deferred gift annuity is established.**

In this example, Jennifer makes an outright gift of $50,000 to Bluefield College now, during a time when she is earning, and her taxes are higher, and guarantees income in her retirement years when she will presumably be in a lower tax bracket. She has also removed $50,000 from her estate, thus reducing potential estate tax liability, if applicable, when she dies. Alternatively, Jennifer could have funded a series of gift annuities for $10,000 each year for five years. This planning strategy takes advantage of the fact that payment rates may increase with each new annuity entered into at an older age. A “flexible” deferred gift annuity would allow Jennifer to take the annuity earlier or later than the target date of 13 years.

The Charitable Remainder Unitrust

In another hypothetical example, we find Sean Kelly who has just reached retirement age and realizes that several of his investments do not yield the income he desires. Also, since these long-term investments have appreciated significantly in value, he will have to pay a substantial capital gains tax if he sells them.

A possible solution to this dilemma is a charitable remainder unitrust that works like this: A donor irrevocably transfers cash, securities, or other property to the trustee named in the instrument, establishing the charitable remainder unitrust. Bluefield College could serve as trustee or it could be a bank, trust company, some other funds manager, or an individual. The trust agreement provides that the trustee shall pay from the trust to the donor (or his spouse, or another beneficiary designated) an annual payment, usually for the life of the beneficiary(ies). The amount of the payment is determined by applying a fixed percentage (not less than 5%) to the trust assets, as valued each year.

The payout percentage is agreed upon when the trust is established. The annual income from a unitrust fluctuates as the value of the trust assets changes, but the payout percentage remains the same. The donor may add to the trust in future years. The trust assets pass to Bluefield College for use in our work when the donor or his other beneficiary(ies) passes away.

Example:

Situation: Sean Kelly has stock he purchased in 1996 for $20 a share. Today it sells for $200 a share. It is paying Sean an annual dividend of 2%. In retirement, Sean needs more income, but if he sells the stock, he will pay at least a 15% capital gains tax on the $180 gain in price of each share since he purchased the stock. Sean's federal capital gains tax could be as high as 23.8% if he is in a high tax bracket.

Solution: Sean creates a unitrust with a 6% annual payout, naming Bluefield College as remainderman, and transfers his stock to the unitrust. The unitrust sells the stock and replaces it with assets that allow the unitrust to pay the 6% annual amount.

Advantages to Sean:

- His annual income from the asset has tripled.
- He avoided paying immediate capital gains tax. (If the annual ordinary income generated by the unitrust is below 6%, the difference between the ordinary income and 6% will pass through to Sean as capital gains until all of the capital gain inside the unitrust flows out to Sean over the years.)
- Sean receives an immediate charitable income tax deduction for the present value of the trust remainder, computed based upon his age, current interest rates, and the current fair market value of the stock when the unitrust is funded.
- Sean's income will increase if the value of the trust grows over time.
- Sean is pleased to know that at his death the remaining trust assets will benefit Bluefield College.

Retirement should be a time in our lives when we can do things such as travel, spend time with our friends and family, and work on behalf of non-profit organizations that perpetuate our values. If we prepare well for retirement, we can indeed find that it will be the best time of our lives.

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