

Giving More to Both Kids and Charities



Tax advisers are pushing new maneuvers that allow taxpayers to get more money to their children and to their favorite cause—at the same time.

Many involve converting an individual retirement account to a Roth IRA. The traditional IRA gets pretax contributions while a Roth gets after-tax contributions. Future withdrawals from a Roth are tax-free.

Until this year, only people with modified adjusted gross income of \$100,000 or less could do Roth conversions. But the income limits have been lifted, and there has been a huge surge in conversions.

Roth conversions are especially attractive to retirees who hope to leave their IRAs largely untouched as an inheritance for their kids and grandkids. By converting to a Roth, the retirees can avoid having to make mandatory withdrawals each year. And the heirs' withdrawals will be income-tax free.

But there is a catch: When you convert to a Roth, you have to pay income tax on assets you are moving from the traditional IRA. Financial planners and accountants usually discourage conversions unless clients can pay those taxes from a separate account.

That is where charitable contributions come into play. If done correctly, the donation can reduce your tax bill.

Martin James, a 51-year-old certified public accountant in Mooresville, Ind., is crunching the numbers to figure out how much his mother, who is 70, can convert to a Roth and give to charity without bumping her and his father into a higher tax bracket. He expects them to use this strategy for a few years, spreading the conversions out to keep the taxes as low as possible. Each year that they declare conversion-related income, his parents will contribute to a donor-advised fund and count it as a charitable contribution, he says.

"You want income-tax deductions in the year you do a Roth conversion, because it might be the most income you ever have in your whole life," says Christopher Hoyt, a law professor at the University of Missouri-Kansas City.

Even if you are converting a smaller IRA, you could set up a donor-advised fund—taking a tax deduction now and recommending the actual grants later—at a mutual-fund company for as little as \$5,000. If you convert \$5,000 and put \$5,000 in the donor-advised fund in the same year, in most cases you pay no additional tax (as long as you itemize).

If you have highly appreciated stock, consider using that to fund the donor-advised fund, Mr. Hoyt suggests. That way, you avoid paying capital-gains tax on the stock but can use its full value to help offset your conversion income.

All in the Family

How to give to charity and leave money to your kids at the same time.

- Start with a \$500,000 traditional IRA when both parents are 65.
- Use the IRA assets to fund a charitable remainder annuity trust with a 10-year term (assuming a 5% return).
- Income tax on IRA withdrawal is \$200,000, but the charitable gift cuts it to \$105,440.
- Use the annuity payments of \$32,500 a year to buy \$1.6 million worth of second-to-die permanent life insurance for your heirs.
- At age 75, annuity trust ends, and \$405,665 in proceeds go to a charitable-gift fund earning 5% a year and making \$20,280 a year in gifts.
- End result at age 85: Charity gets \$608,465. When you die, your heirs get a tax-free insurance trust worth \$1.6 million.

Source: Daniel Nigito, Market Street Philanthropic Advisors Inc.

Glenn Ed and Janet Maurer, a retired couple in their 60s in New Tripoli, Pa., are using this strategy to fund life insurance for their two daughters and four grandchildren, and also to make donations to their church, a food bank and elsewhere. "Why not take control of our money and direct it where we want it to go?" Mr. Maurer says.

By: Kelly Greene

Roth conversions aren't the only tactic. Daniel Nigito, a certified financial planner in Bethlehem, Pa., often advises people converting at least \$200,000 to use a charitable remainder trust to maximize guaranteed contributions to family and charity.

Here is how it works: The parents withdraw the IRA assets they intend to go to their children, and then use them to fund a charitable remainder annuity trust that would make payments to the parents for 10 years. The parents then use those payments to fund permanent, second-to-die life insurance in an irrevocable trust that would go to their children.

Suppose the parents want to convert a \$500,000 IRA. Normally, that would generate about a \$200,000 tax bill. But they could chop that bill to \$105,000 by investing the \$500,000 in a charitable remainder annuity trust.

If the trust paid the parents \$32,500 a year, they could buy \$1.6 million in life insurance that would ultimately go to their children. That is more than three times the value of the \$500,000 IRA. Meanwhile, the trust would ultimately leave \$600,000 to the charity, assuming 5% returns, says Mr. Nigito.