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The Benefits of Deferred Funds in Uncertain Economic Times and Discussing Charitable Giving with Clients

By Scott E. Behnken, President, Behnken Financial Services, Inc.

The uncertainty of the economy is on everyone's mind. Financial planning can be especially challenging in this environment and more important than ever for our clients. For many people, charity is part of that planning process. In these difficult times, charitable giving clearly is more needed than ever and many clients want to help. For this and other reasons, I make sure that the subject of charity is always raised with new clients, and deferred giving is often part of that discussion.

When I sit down with new clients, I walk them through my resume, which includes a statement that my company manages assets for The Dayton Foundation.

This provides me with an opportunity to ask if they've heard of The Dayton Foundation and to initiate a discussion around charitable giving. I bring this up a second time in my conversation with new clients. I ask where they see themselves in three years, what's important to them, what they'd like to do, as well as their financial objectives. I ask if they plan to leave everything to their family, or whether they see charity involved.

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If they have charitable interests, I ask: "If there were a way to leave money to charity and benefit your tax situation at the same time, would that be of value to you?" If they say yes, I show them how family members need not suffer a loss by providing for charity after they pass away.

Deferred Giving

Deferred giving can be a wonderful way to provide for charity. IRAs or other qualified assets are particularly good to use to make a gift to charity, because the taxes on IRAs when they are passed to children at death can be especially high. Retirement assets can be taxed as much as 70% of their value. That's not a prudent use of money.

When the circumstances are right, I may encourage my clients to use life insurance as a wealth-replacement vehicle for their children, while gifting retirement assets to establish a Dayton Foundation fund in their name for the charities they care about the most. This solution can make sense both in terms of the estate taxes saved and in terms of assisting charity – at the same time possibly passing more to the children when the plan is constructed properly.

Let me give you an example of how this can work.

Example

Mr. and Mrs. H are in their early 70s, in good health and have two children they wish to leave assets to after they pass. Mr. and Mrs. H have $1 million in their 403(b) and IRAs, which are overfunded. At death, a portion of their estate would be subject to federal estate tax. A major concern in making their financial and estate plans is their retirement assets, because they could be taxed so heavily at death. They also are concerned with the income taxes their children would have to pay on these inherited retirement assets.

To summarize, Mr. and Mrs. H have an estate tax issue and concerns about their overfunded qualified assets and the ultimate income taxation of these assets to their children.

A Stretch IRA is considered. Mr. and Mrs. H reject this, however, because they believe that all this does is defer the taxes that ultimately would need to be paid.

The idea of leaving assets to charity and including a wealth-replacement vehicle for the children is discussed. Mr. and Mrs. H acknowledge they're open to leaving assets to charity, if it can benefit them in reducing estate taxes and decreasing the income taxes their children would have to pay on inherited 403(b)/IRAs.

The plan that develops is that Mr. and Mrs. H will use a portion of their required minimum distributions from their IRAs and 403(b) assets to pay premiums for a $1 million survivor life policy, of which their children will be the beneficiaries. The residue of their IRA and 403(b) assets after the parents pass will help establish an endowment fund in their names at The Dayton Foundation.

This accomplishes several things.

- They have a plan that enables them to avoid additional federal estate taxes and assures that the children will not pay income tax on the $1 million of qualified money.
- They like that they are constructively using their required minimum distributions –

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Deferred Funds

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which they do not need – to accomplish their financial goals.

- The $1 million of life insurance will transfer to their children federal estate-tax free, Ohio estate-tax free, income-tax free and without probate expense.

Since this is an example based upon real clients, I can tell you that when "Mr. and Mrs. H" and I get together and review their investments, they now always enjoy talking about how these monies someday not only will benefit their children, but also the charities of their choice. As a financial advisor, I can't help but feel good about my clients' pleasure with the result of their plan, which accomplished everything they wanted to accomplish…and more.

People of Modest Means

For people who don't have great means, the situation can be quite different. Frequently people of modest means don't see themselves as being able to give to charity to any substantial degree. But people with no children can be especially good prospects for the charitable question. A number of these individuals I have known have chosen to leave everything to charity once they understand how they can do this in a deferred manner, using IRA, 401(k) and other assets – and the deferred option can be particularly attractive in the current economy. Clients frequently are grateful for this discussion. I've never had a client offended by the charitable question.

A designation of charity in a will or a beneficiary designation of charity to an investment vehicle can provide a simple way to leave money in a deferred manner to a favorite charity, rather than to federal taxes. Tax consequences clearly can be a real encouragement to people to consider either current or deferred charitable gifts.

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Ways to Provide for Your Favorite Charities

Another thing to discuss with clients is the manner in which to provide for their favorite charities. They can support charities themselves in basically one of two ways. They can give a lump sum to a charity and possibly have it gone in a year. Or they can establish a fund at an organization like The Dayton Foundation for the charitable causes they care about and have money support those causes year after year in their name.

Another option is that they can use their Dayton Foundation fund to involve their children in their charitable work. They can set up a donor-advised fund and have their children help them advise grants from it. Or they can make the children successor advisors to the fund, which will allow them to advise grants from the fund after the parents pass away. This can create a family legacy of giving over two or possibly even three generations.

As stated before, deferred giving can make especially good sense to people in uncertain economic times. They're not taking it out of their pocket today – it comes out after death, when they obviously no longer need it. Charity can be the charitable remainder man on a Charitable Remainder Trust or the final beneficiary of a Charitable Gift Annuity. Both of these charitable tools have the added benefit of providing income to donors during their lifetimes.

A deferred, charitable giving example I can tell you about is from my own life. My wife and I have our own deferred, charitable endowment fund, designated for specific, charitable purposes through The Dayton Foundation and which will be funded by qualified assets when we pass away. We also have set up separate deferred funds through The Dayton Foundation for each of our three children.

Upon the deaths of my wife and me, our nonqualified assets will pass to our children and our remaining qualified assets will seed not only our fund, but funds for each of our children. We want them to have the experience of giving money to charity. We're setting up donor-advised funds so each of them can decide where grants from their own endowment fund will go. We hope this experience will influence their lives.

If you haven't had the charitable discussion with your clients, I would urge you to do it. Being able to use your own personal example can only help the discussion. And I wouldn't be surprised if after having the discussion, your client thanks you for it. ❧

Note: Solutions will differ from case to case. The above does not constitute professional financial or tax advice.

Scott E. Behnken, LUTCF, is President of Behnken Financial Services, Inc., and Miami Valley Portfolio Management, Inc., and has over 30 years of experience as a financial consultant. He has helped dozens of clients establish charitable funds with The Dayton Foundation, most of them deferred, charitable funds.

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