

ASK ENCORE

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By Glenn Ruffenach

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Question: *I am a 78-year-old retiree taking required distributions from a 401(k) plan I accumulated while I was working. I am considering naming a charitable organization as the plan's beneficiary. When I die, will the funds be paid to the charity without being taxed, or is there a provision in the tax code that would tax the payment?*

Mr. Ruffenach: The answer, happily, is simple. **And this question gives me the chance to remind readers about a second way to be charitable, one with its own tax advantages.**

Yes, you can name a charity as the beneficiary of a retirement plan, and no, there would be no tax on the transfer to the charity after your death.

“For anyone who is charitably inclined, funds like individual retirement accounts or 401(k)s are actually the best assets to leave to a charity,” says Ed Slott, an IRA expert in Rockville Centre, N.Y. “That’s because they are loaded with deferred taxes that will never get collected when the funds are donated.”

Still, you might decide, at some point, that you would like to see how your donations are helping others before you pass on. In that event, consider making a qualified charitable distribution, or QCD.

As we’ve noted in earlier columns, a QCD is a tax break for individuals age 70½ or older. It allows you to transfer money, tax-free, from an IRA to a charity. (And that presents a wrinkle for this reader: You first would have to roll the funds from your 401(k) into an IRA to take advantage of a QCD.)

Recent changes in tax laws offer additional reasons to consider using a QCD, Mr. Slott says. For instance, Congress recently ended the so-called stretch IRA, which allowed nonspouse beneficiaries (typically, children and grandchildren) to stretch withdrawals from inherited IRAs, along with the tax bite, over their lifetimes. Now, such individuals are required to withdraw all the money, and pay the associated taxes, within a decade of the original account holder’s death.

Given that, QCDs could help your heirs in the long run. Let’s say you begin donating funds from your IRA in the form of QCDs. When you die, your beneficiaries will inherit less of your IRA, which is taxable. But, ideally, these same beneficiaries will inherit more of assets outside your IRA that might have been used for charitable contributions, like cash, stocks, bonds or mutual funds. These, for the most part, won’t be taxable and/or will get a “step up” in cost basis. (Meaning, in effect: Your heirs could save a bundle in capital-gains taxes.)

In short, Mr. Slott says, “by doing the QCDs, **you are giving the taxable assets to charity— at no tax—and leaving the other, better assets to your beneficiaries.**”

Of course, decisions about bequests are highly personal. You might have good reasons for waiting to donate money to a charity until after you die. (Example: You might need your required distribution each year to live on.) And no single approach to gifting is necessarily better than another. Simply be aware that there are other options—options with their own tax advantages—when it comes to helping others.

Mr. Ruffenach is a former reporter and editor for The Wall Street Journal. His column examines financial issues for those thinking about, planning and living their retirement. Send questions and comments to askencore@wsj.com.