

Charitable Planning With An IRA

EXECUTIVE SUMMARY:

The Emergency Economic Stabilization Act of 2008 and the Worker, Retiree, and Employer Recovery Act of 2008 (Signed into law by the President) both expanded and extended charitable giving options through December 31, 2009. The charitable giving options provide significant tax benefits that would otherwise not be available to a taxpayer making a charitable bequest.

FACTS:

Every taxpayer age 70½ and older ("eligible taxpayer") is required to withdraw an amount equal to his or her annual Required Minimum Distribution ("RMD") from their retirement account (IRAs, Roth IRAs and SEP-IRA (if the taxpayer has retired)).

The RMD must be withdrawn on or before December 31 each year.

In August 2006, the Pension Protection Act of 2006 ("PPA"), amended Section 408(d)(8)(A) of the Internal Revenue Code ("IRC") to permit eligible taxpayers to make a direct transfer of up to \$100,000 from their retirement account to charity without including the distribution as taxable income. The PPA provision expired on December 31, 2007.

The Emergency Economic Stabilization Act of 2008 ("EESA"), signed into law on October 3, 2008, extended the charitable giving options contained in the PPA through December 31, 2009.

Subsequently, 2009 tax planning opportunities were further expanded by enactment of the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA") (now signed into law). WRERA suspends the minimum required distributions in 2009 for eligible taxpayer's (otherwise a 50% tax would apply to the amount not withdrawn).

TAX BENEFITS:

IRA Rollover Qualifies for RMD:

Despite the fact that RMD is *calculated* on January 1 of each taxable year, a large number of IRA owners *receive* their RMD at the *end* of the fiscal year. This allows the IRA assets to continue growing (in most years) tax-free before

they are required to be withdrawn (on or before December 31).

Under EESA, instead of receiving the RMD and including the funds into taxable income, a taxpayer may contribute (through a charitable rollover) his or her RMD to a Charitable Organization.

The charitable rollover is limited to \$100,000 per taxpayer (a husband and wife may contribute \$100,000 *each* from two separate IRA accounts).

While the charitable rollover will not be eligible for a corresponding charitable deduction, the taxpayer must still establish that the contribution was a "qualified charitable distribution" under IRC Sec. 408(d)(8)(B).

State Tax Impact:

States fall into several different categories with respect to the charitable IRA rollover. States either:

- (i) do not provide for charitable income tax deductions;
- (ii) permit charitable deductions, but use the federal adjusted gross income as an initial reference number for determining state tax; or
- (iii) do not recognize the IRA charitable rollover and require IRA reporting for state income tax purposes.

Under each scenario, a taxpayer will benefit from the IRA rollover by reducing their state taxable income and reducing his or her state taxes.

Income Tax Benefits:

An eligible taxpayer who receives a distribution from his or her IRA must include the funds as part of their gross income.

A corresponding charitable contribution will provide a charitable deduction for the amount transferred to charity.

However, an eligible taxpayer in one of the highest income brackets may not be able to totally offset the tax associated with the RMD received with a corresponding charitable contribution. This is because eligible taxpayers can deduct

- (i) *cash* contributions in full up to 50% of their adjusted gross income;
- (ii) *property* contributions in full up to 30% of their adjusted gross

income; and

- (iii) contributions of *appreciated capital gains assets* in full - up to 20% of their adjusted gross income.

Charitable contributions in *excess* of the limits can be carried over for a maximum of five years.

Utilization of a charitable rollover will allow a taxpayer to avoid

- (i) inclusion of the RMD in their Adjusted Gross Income ("AGI");
- (ii) the payment of federal and/or state income tax on the RMD;
- (iii) the phase out of income tax exemptions resulting from higher AGI levels,
- (iv) increased social security taxation (avoidance of the 50% or 85% level of taxation); and
- (v) the higher capital gains tax rate (15%).

It will also benefit eligible taxpayer's who utilize the standard deduction (the charitable deduction is an itemized deduction) and would otherwise not be able to benefit from the charitable deduction on their income tax return.

ELIGIBLE CHARITABLE ORGANIZATIONS:

Both the PPA and EESA require that the charitable rollover be made to an IRC Sec. 509(a)(1) or IRC Sec. 170(b)(1)(A) charity (collectively a "Charitable Organization").

Eligible entities include a

- (i) community foundation;
- (ii) private foundation (which meets the conduit rules);
- (iii) college or university scholarship fund; or
- (iv) relief organization.

The charitable rollover may also be utilized to satisfy a charitable *pledge* (IRS Notice 2007-7). In contrast, a charitable rollover may not be made to (i) an IRC Sec. 509(a)(3) supporting organization; (ii) IRC Sec. 4966(d)(2) donor-advised fund; (iii) private foundations (which do not meet the conduit rules); (iv) split

interest trusts (charitable lead and remainder trusts); or (v) pooled income fund.

LIMITATIONS AND RESTRICTIONS:

Charitable donations from 403(b) plans, 401(k) plans, pension plans, and other retirement plans are *ineligible* for the tax-free treatment.

Distributions must be made *directly* from the IRA trustee payable to the Charitable Organization.

The recipient organization should issue an acknowledgment for the IRA rollover. The acknowledgement should include

- (i) the date of the gift;
- (ii) the name of the IRA custodian;
- (iii) the amount of the gift;
- (iv) that the gift is a qualified charitable distribution under IRC Sec. 408(d)(8)(A); and
- (v) state that no goods or services were provided in exchange for the gift.

CONCLUSION:

In 2009, eligible taxpayers will have the option of (i) a charitable rollover of their RMD; or (ii) retention of the funds in their IRA for continued tax-free growth. Either way, eligible taxpayers will have significantly expanded options in 2009.