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IRA Charitable Rollover Passes!

The Pension Protection Act of 2006 (PPA 2006) passed the House and Senate by wide margins. It is potentially the most favorable charitable legislation in many years.

IRA Charitable Gifts of \$1 Billion Plus

Sen. Charles Grassley (R-IA) obtained an agreement to attach charitable legislation to PPA 2006 (H.R. 4). The long-awaited charitable legislation includes both incentives and reforms. The charitable incentives open up powerful new options for a potential \$1 billion or more in new charitable giving from IRAs. These gift opportunities will be for current IRA rollover gifts from individuals age 70½ and above. Gift planners and professional advisors will benefit from understanding the probable gift profiles for IRA owners.

Current IRA Gifts

There are five general categories for current IRA gifts. These are the convenience donors who simply find it a very simple and easy method for an end of year gift. The second is the generous donor, who wants to give past the 50% of AGI limit. The third is a major donor. This person may be a board member or trustee who is looking for a favorable opportunity to make a major gift. Fourth, a standard deduction donor will benefit from a direct IRA to charity gift. Finally, the Social Security recipient may also benefit from IRA gifts.

Convenience Donor

The majority of IRA owners delay taking IRA withdrawals until November or December each year. This occurs for two principal reasons. First, the longer the funds are in the IRA, the more time there is to benefit from tax-free growth. Second, many IRA owners do not need the IRA income to cover their living expenses.

As the individual approaches the end of the year, he or she will need to make decisions. If an IRA owner is actively making gifts to charity during the year, then it may occur to him or her that this is a good opportunity to make a gift.

Major financial services companies and charities will make it very easy to complete the gift. According to the budget proposal of President Bush, the gift will satisfy the requirement for the minimum distribution for that year.

While there is at present no specific guidance from the IRS, it is probable that the IRA charitable gift will qualify for the required minimum distribution. By directing the IRA custodian to transfer the required minimum distribution (RMD) directly to charity, the donor does not have to report it in his or her tax return.

There is no charitable income tax deduction, but also no inclusion. It is simply a very convenient way to help your favorite charity. Since the convenience donor may be a person with a small or medium value in the IRA, this probably will be the largest numeric category of donors.

Generous Donor

Some very generous individuals are already giving to the 50% of adjusted gross income level. This is the maximum permissible level for cash gifts each year. The excess gifts may be carried forward and deducted over the following five years.

Some of these generous donors may also have a large IRA. Since they frequently live at a moderate level in proportion to their income and assets, they may not actually need all of their IRA.

If there is a desire to give more, they can give to 50% of adjusted gross income from their regular assets and then make "over and above" gifts from their IRA. Some generous donors may in effect give 100% or more of income per year through this method. Since the IRA is not included in taxable income, it will have no impact on their regular income and other charitable gifts.

Major Donor

Board members, trustees and other major donors frequently are asked to make gifts of \$100,000 or more. As the rules have continually become more favorable for IRAs and the withdrawal schedule has been reduced, large IRAs will continue to grow. Over longer periods of time, there are occasional market dips and drops, but the longer-term trend is positive and large IRAs will continue to increase in value.

For many professionals and business owners, the IRA may even become the vast majority of the estate. They have a need to do some "asset balancing" or there may be major future income tax problems.

Therefore, it may be desirable for the major donor to give \$100,000 per year to charity from his or her IRA. This has the advantage of "balancing" the estate assets.

In addition, there may be income tax benefits. If the donor were to take the IRA into his or her own personal income, there are several types of exemptions that are phased out at higher income levels. Thus, it may actually be preferable to make the gift directly from the IRA rather than making a charitable gift from regular income.

Standard Deduction Donor

Many seniors do not have a mortgage and their medical deductions are less than 7.5% of adjusted gross income. Thus, they may not have a sufficient level of deductions to itemize and choose instead to use the standard deduction.

If this donor withdraws \$1,000 from his or her IRA and then gives it to charity, there is \$1,000 of increased income with no offsetting charitable deduction, since the standard deduction is taken. Therefore, it will be preferable for all donors taking a standard deduction to make IRA gifts directly to charity and avoid the additional income tax otherwise payable.

Income Tax on Social Security Donor

Social Security is subject to two levels of taxation. For donors who have income in excess of the first level, 50% of Social Security is taxed. For donors with income in excess of the second level, up to 85% of Social Security income may be subject to tax.

Withdrawing an amount from an IRA will potentially cause the recipient's income to increase from the 50% taxable bracket to the 85% Social Security taxable bracket. Even though the withdrawn amount is given to charity and deducted, there still is taxation with the added 35% bracket. Thus, by making the transfer directly to charity, many Social Security recipients will save substantial taxes.

Gift Potential (Estimates)

The estimate of the actual dollar values of gifts involves very substantial assumptions. Thus,

these numbers are extremely general, but they perhaps will give some perspective on the potential in this area.

The Federal Reserve System regularly tracks IRA balances. While the numbers have changed somewhat during the years due to the market changes, approximately \$3 trillion is now in IRAs.

Another assumption that is based on very rough actuarial estimates is that perhaps \$500 billion of this total is owned by individuals over 70. If one assumes that the median age of these individuals is approximately 79, then the required minimum distribution is approximately 5% or \$25 billion per year. Once again, the author emphasizes these are very approximate numbers, but may be useful in estimating potential gifts.

Donor Gift Values (Estimated)

Assuming that the over-70 donors will be required to take \$25 billion per year in minimum distributions, one can at least make some estimates of probable gifts.

First, the convenience donors could give 1% of the total or \$250 million per year. Generally, giving to charity equals about 2% of income per year. Thus, this seems a reasonable estimate.

Generous donors are much smaller in number. However, the gift per donor will probably be larger than with the convenience donors. Thus, an amount of \$25 million to \$50 million per year seems possible.

Major donors are yet smaller in number, but will have a much larger average gift size. Therefore, it will not take as many gifts of \$100,000 to produce a significant number. Major donor gifts could be from \$50 million to \$100 million.

IRA Gift Requirements

There are four requirements for a qualified IRA charitable gift. First, the IRA gift must otherwise have been includible ordinary income to the IRA owner. Second the IRA owner must be 70½ or older. Third, the gift must be to a qualified exempt public charity, and may not have any limitations that would disqualify a charitable deduction. Fourth, the recipient may not be a private foundation, supporting organization or donor advised fund. Advisors should be careful if donors plan to make gifts to foundations for universities or medical centers, since some are supporting organizations. Many university and medical center foundations will file for

exempt status as Sec. 509(a)(1) charities to permit them to receive IRA gifts.

Conclusion

The \$100,000 IRA charitable gifts provision opens up many new gift opportunities.. Charities and allied professionals will want to explore all of these gift benefits with donors and clients. Everyone will appreciate the great new flexibility of IRA charitable gifts. As the age wave meets the IRA wave, there are major charitable giving opportunities ahead.

Special Thanks

The \$100,000 IRA charitable gifts provision is the direct result of the wisdom, insight and persistent efforts over two decades by attorney Conrad Teitell. His volunteer IRA Rollover Rangers coalition made many personal contacts with key senators, representatives and staff. The result of these IRA Rollover Ranger contacts was the current IRA gifts provision that could provide up to \$1 billion in new funding for philanthropy in 2006 and 2007.

Pension Protection Act of 2006 - IRA \$100,000 Charitable Gifts Provision

SEC. 1201. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR CHARITABLE PURPOSES.

(a) IN GENERAL.-Subsection (d) of section 408 (relating to individual retirement accounts) is amended by adding at the end the following new paragraph:

(8) DISTRIBUTIONS FOR CHARITABLE PURPOSES.-

(A) IN GENERAL.-So much of the aggregate amount of qualified charitable distributions with respect to a taxpayer made during any taxable year which does not exceed \$100,000 shall not be includible in gross income of such taxpayer for such taxable year.

(B) QUALIFIED CHARITABLE DISTRIBUTION.-For purposes of this paragraph, the term 'qualified charitable distribution' means any distribution from an individual retirement plan (other than a plan described in subsection (k) or (p))- (i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and (ii) which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 70 1/2. A distribution shall be treated as a qualified charitable distribution only to the extent that the distribution would be includible in gross income without regard to subparagraph (A).

(C) CONTRIBUTIONS MUST BE OTHERWISE DEDUCTIBLE.-For purposes of this paragraph, a distribution to an organization described in subparagraph (B)(i) shall be treated as a qualified charitable distribution only if a deduction for the entire distribution would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph).

(D) APPLICATION OF SECTION 72.-Notwithstanding section 72, in determining the extent to which a distribution is a qualified charitable distribution, the entire amount of the distribution shall be treated as includible in gross income without regard to subparagraph (A) to the extent that such amount does not exceed the aggregate amount which would have been so includible if all amounts distributed from all individual retirement plans were treated as 1 contract under paragraph (2)(A) for purposes of determining the inclusion of such distribution under section

72. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(E) DENIAL OF DEDUCTION.-Qualified charitable distributions which are not includible in gross income pursuant to subparagraph (A) shall not be taken into account in determining the deduction under section 170.

(F) TERMINATION.-This paragraph shall not apply to distributions made in taxable years beginning after December 31, 2007.