Charitable Giving with Retirement Plan Dollars Has Never Been Easier and Less Taxing

By Marvin R. Rotenberg and Mark S. LaVangie

Marvin Rotenberg and Mark LaVangie explain why, if your clients are interested in charitable giving, there has never been a better opportunity to use tax-advantaged retirement plan assets to make charitable gifts.

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While charity in heart and spirit is an admirable virtue, deciding whether to give your hard-earned retirement plan dollars to charity can be a difficult decision. Estate taxes, income taxes and family inheritance considerations all play a critical role in the decision making process. There are many good reasons to consider charitable giving and using tax-advantaged retirement plan assets to make the charitable gift has become easier than ever before for two reasons. First, final regulations governing required minimum distributions from IRAs and employer provided retirement plans, which were released by the Internal Revenue Service in 2002, eliminated inherent disadvantages in naming a charity as a beneficiary of a retirement account. Second, the recent passage of the Pension Protection Act of 2006 (PPA)[1] allows individuals age 70 ½ and older to make limited direct gifts of IRA dollars to charity without incurring any income tax. Both of these events provide IRA owners with a good opportunity to satisfy their philanthropic desires.

For satisfying charitable bequests at death, tax-deferred retirement plan assets may provide substantial leverage. The imposition of both estate and income taxes on traditional IRAs and employer qualified plans (e.g. Keogh Plans, Profit Sharing Plans, Pension Plans, 401(k) Plans, 403(b) Plans, etc.) makes them extremely attractive assets to use in satisfying charitable bequests.[2] The reason? Retirement plan assets left directly to charity are subject to neither estate nor income taxes.

Prior to the release of revised proposed regulations in 2001 and then final regulations in 2002, the rules governing required minimum distributions from tax-advantaged retirement plans contained a major disadvantage in naming charity as a retirement plan beneficiary. Under the old rules, the retirement plan account owner had to use his or her single life expectancy to calculate required minimum distributions if a charity was named as beneficiary (as opposed to a joint life expectancy if the beneficiary was an individual.) This forced larger distributions and a higher income tax liability on the account owner. The playing field has been leveled under the revised rules. Due to the standardization of life expectancy tables used in calculating required payments, an IRA owner or qualified plan participant is no longer penalized in the form of larger distributions for naming a charity as a beneficiary.[3]

What is the situation if, in addition to charity, the account owner has also named one or more individuals as beneficiaries? The final regulations provide more flexibility with respect to post-mortem planning options when it comes to structuring tax-fa-

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vorable payouts from multiple-beneficiary retirement accounts. This is particularly true when one of the beneficiaries is a charity. For instance, if the charity is paid its share of the account by September 30th of the year following the year of the account owner's death ('the determination date"), the other beneficiaries will, if the underlying IRA or plan agreement allows, have the opportunity to extend the distribution payment period over each of their own single life expectancies.[4] Thus, unlike the old rules, naming a charity as one of a number of beneficiaries for a retirement account no longer locks in a single life expectancy payment period at the account owner's required beginning date for distributions. This allows for the stretching out of post-death payments over each remaining beneficiary's life expectancy, potentially minimizing the beneficiary's annual income tax liability and potentially providing an opportunity for decades of tax-deferred growth.

One provision that was not changed by the final regulations relates to the taxation of charitable bequests from retirement assets. To the extent retirement assets are paid directly to charity after the account owner's death, there will be no estate or income taxes.

Because QCDs from IRAs will eliminate the need for donors to claim a charitable deduction for income tax purposes, non-itemizers will enjoy the equivalent of a charitable deduction.

The use of charity as a retirement plan beneficiary can occur in a few different ways. The most common is for the account owner to name charity as the primary beneficiary, standing first in line to inherit. Alternatively, charity can be named as a contingent or secondary beneficiary, providing the primary beneficiary with the option of disclaiming some or all of the assets to the charity within nine months of the account owner's death. This can be a beneficial post-mortem estate-planning tool to assist in the avoidance or mitigation of estate and income taxes when necessary or desired.

Charitable beneficiaries also appear in a host of different forms. Charitable organizations, charitable remainder trusts and family foundations are a few of the more customary charitable beneficiaries. Each has its own set of characteristics, rules and benefits.

Gifting IRA money to charity during lifetime has also become much easier for some individuals as a result of The Pension Protection Act of 2006 (PPA). President Bush signed PPA into law on August 17, 2006. A provision of the PPA provides an exclusion from gross income for "Qualified Charitable Distributions" (QCDs) that are made directly from an IRA to an eligible charity.[5] QCDs are otherwise taxable distributions up to an aggregate maximum of $100,000 per year, per individual from traditional IRAs and Roth IRAs. As an added bonus, QCDs distributed from traditional IRAs will count towards satisfying an IRA owner's required minimum distribution in the year they are paid. The following special conditions also apply:

- IRA owner must be age 70 ½ or older on the date the distribution is made;
- Qualified charities do not include donor advised funds or supporting organizations;
- Distributions must occur in 2006 and 2007 and go directly from the IRA to the charity only;
- IRA owner cannot receive any benefit from the Charity as a result of the QCD; the gift must otherwise be fully deductible in order to qualify.

Distributions from SIMPLE IRAs and SEP-IRAs are not eligible under PPA. Other forms of retirement plans such as 401(k)s, 403(b)s, annuities, defined benefit and defined contribution plans, and Keoghs are also not eligible. Owners of ineligible plans however, may want to consider rolling some of those plans into a qualifying IRA to take advantage of the new rules.

Except for QCDs, the tax system discourages donors from making gifts of IRAs (and other tax-advantaged assets) to charity during the account owner's lifetime. To do so would require an IRA owner to withdraw money from the IRA and then make a subsequent gift to charity. The amount taken out of the IRA and then given to charity would be subject to income tax and then possibly be offset by use of a charitable income tax deduction. This two-step scheme is problematic for donors who wish to contribute IRA assets to charity, but do not itemize deductions. But giving IRA assets (as opposed to other types of assets) to charity during life has significant advantages from an estate planning perspective. A primary goal of lifetime giving, for a donor with significant wealth, may be to reduce the size of their taxable estate.[6]

While the amount of distribution to charity directly from the IRA is limited to $100,000 per year, per indi-

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vidual, a married couple may donate up to $200,000 per year provided each spouse owns at least one IRA and can make a qualified charitable distribution of up to $100,000 from their IRA.

A QCD may not be given to a donor advised fund or supporting organization. Field of interest funds, designating funds, scholarships, and restricted or general endowments, for which donors or their designers have no advisory rights, are perfectly suitable recipients for charitable IRA distributions.

QCDs include only amounts that otherwise would be includible in gross income if distributed to the IRA owner. Some IRA owners make non-deductible contributions to their IRAs that if withdrawn would be considered a tax-free return of a nondeductible contributions. Such distributions are not classified as QCDs. However, when an IRA has both deductible and nondeductible contributions the taxable distributions are considered distributed first in the case of a QCD. All of an individual's IRAs must be taken into consideration when determining the amount of funds available to be used for QCD purposes. For example, if an individual owns two IRAs, each with a total fair market value of $100,000 of which $50,000 consists of nondeductible contributions, the IRA owner can donate one of the accounts in its entirety and treat the entire distribution as a QCD. The remaining IRA will be treated as consisting entirely of nondeductible contributions.

Commencing in 2007, the IRS will require the donor to obtain sufficient substantiation from the charity that a gift has been made. If the check is coming directly from the IRA trustee or custodian, steps should be taken to ensure the charity is expecting it and knows the identity of the donor. Ideally, the transmittal should identify an account owner as the donor. Donors may also be wise to contact the charity independently and let them know a gift is on the way. As an alternative, donors may want to request the check, payable to the charity, be mailed to them personally. The donor then can deliver the check to charity. However, the IRA trustee or custodian would have to consent to delivering the funds in this manner. It is important to note that IRA trustees and custodians have full discretion in establishing their own policies, procedures and guidelines with respect to the processing of QCDs. They are not compelled by the PPA to comply with a request to deliver a check to an IRA owner that is payable to charity. Also, they will be able to set minimum values to process a QCD, and limit the number of QCDs an IRA owner may make in either 2006 or 2007. For example, most institutions will not have any desire to process two hundred, $500 QCDs for an IRA client.

The PPA is welcome relief to many IRA owners who have philanthropic desires. Because QCDs from IRAs will eliminate the need for donors to claim a charitable deduction for income tax purposes, non-itemizers will enjoy the equivalent of a charitable deduction. In fact, some donors who were itemizing for the sole purpose of claiming deductions for their charitable gifts may no longer need to do so if they fund their gifts from their IRAs. The new rules may also be attractive to residents of states with no state income tax because relatively fewer taxpayers in those states itemize deductions. In addition, some states do not allow itemized deductions for state income tax purposes.[7]

The gifting of tax-advantaged retirement plans to charity may provide the account owner with a sense of fulfillment, and his or her estate with substantial tax relief.

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Many wealthy individual donors may have maximized their ability to claim income tax charitable deductions due to the 50 percent of AGI limitation. These donors will find they can give more because QCDs operate independently of the percentage limitations rules, and therefore, do not affect other gifts to which the limitations apply. Using QCDs from IRAs will also benefit higher income earners. The impact of receiving additional income on the taxability of social security payments, the phase-out of itemized deductions and child tax credits, and application of the alternative minimum tax can often result in net income tax cost of making charitable gifts.

The gifting of tax-advantaged retirement plans to charity may provide the account owner with a sense of fulfillment, and his or her estate with substantial tax relief. The potential benefits that can result from either naming a charity as a beneficiary of a tax-deferred retirement plan or making use of the QCD provision with respect to an eligible IRA should be carefully examined when the appropriate situation presents itself. And remember; absent any future legislation extending their availability, QCDs can only be made in 2006 and 2007. Time is of the essence in planning for this opportunity.

ENDNOTES

[*] Investment Products:

Are Not FDIC-Insured	May Lose Value	Are Not Bank-Guaranteed

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[1] P.L. 109-280

[2] This excludes Roth IRAs. Payments from Roth IRAs will generally be tax-free, rendering them much less attractive than their tax-deferred brethren as charitable bequest vehicles.

[3] IRS Publication 590, Appendix C, Life Expectancy Tables.

[4] Treas. Reg. §1.401(a)(9)-4, A1.

[5] Code Sec. 170(b)(1)(A).

[6] Code Sec. 2010(c).

[7] For example, the states of Indiana and Ohio, and The Commonwealth of Massachusetts.

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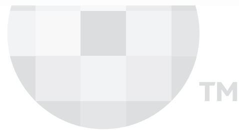

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