

IRA Rollover Passes for 2008/2009! Good News! The IRA Charitable Rollover Passed!

In "Division C -- the Tax Extenders and Alternative Minimum Tax Relief Act of 2008" of H.R. 1424, Congress extended an excellent charitable planning opportunity for both 2008 and 2009. This act permits an IRA owner age 70½ or older to make a direct transfer to charity. The transfer may be up to \$100,000 in one year and this IRA rollover will exist for year 2008 and year 2009. Sec. 408(d)(8)(A).

IRA Charitable Rollover Guide

Introduction

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Permitted IRA Rollover Gifts

IRA Rollover gifts may be made to Sec. 509(a)(1) and Sec. 170(b)(1)(A) public charities. This can also include Sec. 170(b)(1)(A) conduit foundations. In most cases, IRA rollover gifts will be a transfer from a regular or Roth IRA to a public charity for the general purposes of that charity. However, it is permissible to make a transfer to a field of interest fund or for a qualified charitable purpose. For example, a transfer from an IRA owner age 71 to a college or university for a particular scholarship fund is permitted. Similarly, a transfer to a relief organization for a specific disaster relief fund is also acceptable.

IRA Rollovers To Pay Pledges

Many tax advisors were concerned that IRA rollovers to pay pledges would be restricted in the same manner that payment of pledges from donor advised funds are restricted. However, since the IRA funds are owned by the IRA owner, they may be used to fulfill a legally-binding pledge. The transfer from the IRA owner to the charity is treated as a receipt of assets followed by a gift from the IRA owner under Sec. 4975(d)(9). Therefore, the IRA rollover is not a prohibited transaction. See Notice 2007-7.

IRA Rollover Gifts Not Permitted

There are a number of restrictions on the "qualified charitable distribution" (QCD). The QCD may not be made to a Sec. 509(a)(3) supporting organization or to a donor advised fund described in Sec. 4966(d)(2). Since the rollover is limited to organizations in Sec. 170(b)(1)(A), private foundations are also excluded, with the exception of the conduit private foundation.

Many charitable organizations and professional advisors hoped that the IRA Rollover would be extended to charitable remainder unitrusts, charitable remainder annuity trusts, pooled income funds and charitable gift annuities. The current IRA rollover does not include any of these options.

Finally, the "entire distribution" transferred to the charity must qualify for a Sec. 170 charitable deduction. Sec. 408(d)(8)(C). Therefore, a "quid pro quo" transfer is not permitted. The IRA charitable deduction may not be used to purchase a banquet table for a donor, family and friends at the annual charitable auction. Similarly, the gift may not be used to qualify for preferential seating at athletic events or other types of "quid pro quo" gifts.

IRA Rollover Qualifies for RMD

Each year, IRA owners age 70½ and older must take a required minimum distribution (RMD). The RMD in nearly all cases is calculated using the Uniform Table. Under the Uniform Table, distributions generally commence at age 71 at approximately 3.8% and increase each year based on the age of the IRA owner.

The required distribution is calculated by determining the expectancy under the Uniform Table, the IRA fair market value on December 31 of the previous year, and multiplying a fraction of one divided by the applicable expectancy times this fair market value. The RMD must be taken by December 31 each year.

The vast majority of IRA owners with larger balances take the required minimum distribution during the months of October, November and December. Because many individuals with larger IRAs do not require IRA funds immediately for living expenses, by delaying an RMD until the end of the year they benefit from additional tax-free growth in the IRA.

Fortunately, the IRA charitable rollover will qualify for the donor's RMD. The Congressional Joint Committee on Taxation Technical Explanation of PPA 2006 (JCX-38-06) states on page 266, "Qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the provision."

Since most IRA owners take the RMD during the 4th calendar quarter of each year, they are likely to contact advisors to discuss the benefits of receiving the full RMD or giving part or all of it to charity. By transferring part or all of their RMD to charity, they will have a lower taxable income. This could both simplify their tax return and reduce income taxes.

IRA Custodians

IRA custodians generally have IRA distribution forms that may be obtained by mail or downloaded from their web sites. In order to obtain an IRA distribution, many owners will download the distribution form and select the type of IRA distribution. Since there are a number of options for individuals to take distributions at given ages and under various exceptions, the distribution forms typically already have three to six options that may be selected.

It is anticipated that IRA custodians will add the IRA charitable rollover to the other distribution categories. In this case, an IRA owner will select the IRA charitable rollover, designate the charity by legal name, city and state, and enter the amount of the rollover. The IRA custodian will then make the transfer. It is uncertain whether or not IRA custodians will determine that the designated charity is qualified under the applicable rules for the IRA rollover.

IRA custodians have asked Treasury whether or not they are required to exercise due diligence to determine that the charity qualifies for an IRA rollover. Supporting organizations, donor advised funds of public charities and donor-benefit gifts are not qualified for the IRA rollover. Notice 2007-7 indicates that the IRA custodian may rely upon "reasonable representations made by the IRA owner." As a result, the distribution is not subject to withholding and the IRA owner is at risk with respect to a potential nonqualified transfer.

IRA Donor Actions

IRA owners age 70½ and above typically contact their IRA custodian during the 4th quarter of each year and specify the amount of their IRA distribution. Most IRA owners with larger IRAs specify an amount equal to the required minimum distribution based on their age, their IRA balance the previous December 31 and the Uniform Table rules. If an IRA owner over 70½ desires to make an IRA charitable rollover, it will be necessary to download the applicable form with the addition of the charitable IRA rollover or obtain an IRA charitable rollover form by mail from the IRA custodian.

If the IRA custodian does not have a specific form, the IRA owner may send a letter to the IRA custodian similar to the following:

Dear IRA Custodian,

Sec. 408(d)(8)(A) of the Internal Revenue Code permits an IRA rollover directly from an IRA custodian to a qualified public charity. As the owner of IRA account #123-456789 that is in the custody of your organization, I request that you transfer from that account the sum of \$1,000 to Favorite Public Charity, 123 Oak Street, Chicago, Illinois 52001. The Treasury Tax ID Number for Favorite Public Charity is 00-0000001.

It is my intention to make a Qualified Charitable Distribution (QCD) to Favorite Public Charity from my IRA as permitted by law. Under the Congressional JCT Technical Explanation of Sec. 408(d)(8)(A), this QCD will fulfill part or all of my IRA required

minimum distribution for this year.

This letter is sufficient authorization for you to make this QCD gift. However, if you require any further documents, please forward those to me for my signature.

Cordially yours,

IRA Owner

After the IRA owner has the appropriate form as required by the IRA custodian, he or she will need to specify the amount of the charitable IRA rollover (not to exceed \$100,000 in one year). Since the limit is for "a taxpayer," a husband and wife could each give up to \$100,000 from two separate IRA accounts. Even in community property states, the \$100,000 limit will apply to each account.

The IRA distribution form should, at a minimum, require the legal name, city and state of the charity. Since the charity must be a public charity and not a supporting organization, if the donor or his or her advisor are uncertain, contact should be made with the charity to make certain that it is a qualified public charity and not a supporting organization.

Most IRA custodians transfer IRA rollover funds by check or electronic transfer directly to the charity. However, some IRA custodians issue a check payable to the charity, but send the check to the donor for forwarding to the charity. This transaction will still qualify under Sec. 408(d)(8) as an IRA rollover if the check is issued payable to the charity and the owner delivers the check prior to December 31 of the applicable year. Delivery may be made by physical transfer to an agent for the charity or by placing the check in the U.S. mail by December 31 of the appropriate year.

Treasury IRA Rollover Guidelines

In Notice 2007-7, Treasury released guidelines on IRA rollover provisions of the Pension Protection Act of 2006. Section IX of the Notice offers several clarifications on IRA rollovers from custodians to charities. Notice 2007-7 clarifies specific issues concerning the timing of the transfer, transfers by husbands and wives, qualifications of the charitable recipient, acknowledgements by charities, and fulfillment of pledges with IRA gifts.

IRA Rollovers To Pay Pledges - Because the IRA funds are owned by the IRA owner, they may be used to fulfill a legally-binding pledge. The transfer from the IRA owner to the charity is treated as a receipt by the owner under Sec. 4975(d)(9) and therefore the IRA rollover is not a prohibited transaction.

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IRA Custodian May Rely on IRA Owner Representation - IRA custodians have inquired whether or not they are required to exercise due diligence to determine that the charity qualifies for an IRA rollover. Supporting organizations, donor advised funds of public charities and donor-benefit gifts are not qualified. The Notice indicates that the IRA custodian may rely upon "reasonable representations made by the IRA owner." As a result, the distribution is not subject to withholding and the IRA owner is at risk with respect to a potential nonqualified transfer.

IRA Rollover Not Qualified - If the transfer is not qualified because the IRA owner is less than age 70½, the transfer is to a supporting organization or a donor advised fund or there is a donor-benefit gift, then the distribution is taxable to the owner under Sec. 408. However, the owner will qualify for a charitable deduction under Sec. 170 if the transfer is to a qualified charitable organization. With the 50% of AGI limit for charitable gifts of cash to public charities, it is possible that the gift may not be fully deductible in the year of the transfer. In that case, the excess may be carried forward for up to five years.

Charitable Deduction and Reporting - The IRA rollover is not included in taxable income and consequently there is no income tax deduction. However, the donor must still comply with substantiation requirements under Sec. 170(f)(8). The recipient charity should issue an acknowledgment for the IRA rollover that is similar to a gift receipt. The acknowledgement should include the date of the gift, the name of the IRA custodian, the amount of the gift, that the gift is a qualified charitable distribution under Sec. 408(d)(8)(A), and state that no goods or services were provided in exchange for the gift. Finally, the acknowledgement should state that the charitable organization has received the gift for general purposes or a field of interest fund, that it qualifies as a Sec. 170(b)(1)(A) public charity, and the gift is not to a Sec. 509(a)(3) supporting organization or Sec. 4966(d)(2) donor advised fund.

Ongoing SEP-IRA Rollover - IRA rollovers are permitted generally for most IRAs. There is an exception for the SEP-IRA or a SIMPLE IRA if the employer has made a contribution during the taxable year. However, if an employee has retired and the employer is no longer making contributions to the SEP-IRA, then it qualifies for the Sec. 408(d)(8)(A) IRA rollover.

Husband and Wife IRA Rollovers - The IRA rollover is limited to \$100,000 per IRA owner each year. A husband and wife may each transfer up to \$100,000 from his or her personal IRA account to a qualified charity. If both husband and wife have substantial IRA accounts, then up to \$200,000 per year may qualify for IRA rollovers.

State Tax Impact

There are at least three different categories of states with respect to the charitable IRA rollover. First, some states do not presently provide for charitable income tax deductions. In Indiana, Michigan, New Jersey, Ohio, Massachusetts and West Virginia, there are no state charitable itemized deductions. Therefore, donors will effectively benefit from the IRA rollover by reducing their state taxable income and reducing their state taxes. Both these donors and the federal nonitemizer donors will benefit directly by making charitable gifts from their IRAs.

Second, some states permit charitable deductions, but use the federal adjusted gross income as an initial reference number for determining state tax. In this circumstance, the reduced adjusted gross income as a result of the charitable IRA rollover will also reduce state taxes.

Finally, there may be some states in which the state does not recognize the IRA charitable rollover and requires IRA reporting for state income tax purposes. In those states, the distribution to charity would normally be deductible on state income tax returns, but may be subject to state limits, such as the 50% of adjusted gross income limit for charitable gifts in one year.

Rollovers From Other Qualified Plans to IRAs

IRA rollovers are permitted generally for most IRAs. There is an exception that does not permit an IRA charitable rollover from a SEP-IRA or a SIMPLE IRA if the employer has made a contribution during the taxable year. However, if an employee has retired and the employer is no longer making contributions to the SEP-IRA, then it qualifies for the Sec. 408(d)(8) IRA rollover. See Notice 2007-7.

Approximately one-third of all qualified plan assets are held in IRAs that qualify for the IRA charitable rollover. However, substantial assets are held in 401(k), 403(b), SEP-IRA and other plans. Under federal tax rules, these and other qualified plans generally may be rolled directly over from the current plan custodian to an IRA custodian. If there is a limitation on rollovers, it is usually due to provisions in the plan document and not in the Internal Revenue Code. Upon request, the plan administrator should disclose any rollover-to-an-IRA limitations.

In Reg. 1.401(a)(9)-7 Rollovers and Transfers, Treasury explains how to roll over from another qualified plan to an IRA. In Question 3 the "transfer of an amount of an employee's benefit from one plan" must follow "special rules for satisfying Sec. 401(a)(9)." In Answer 3 the "transferor plan must determine the amount of the required minimum distribution" and comply "by segregating the amount which must be distributed from the employee's benefit and not transferring that amount. Such amount may be retained by the transferor plan and must be distributed on or before the date required under Sec. 401(a)(9)."

Therefore, before the rollover to the IRA the retirement plan benefit owner will calculate and take the required minimum distribution (RMD) for that year. Following the RMD payout, the qualified plan is rolled over to the IRA. After the rollover to the IRA, he or she may still make an IRA charitable rollover up to \$100,000, but it will not be part of the RMD for that year. In the following year, the IRA owner may make IRA charitable rollovers that will qualify as part or all of the RMD.

Conclusion

The \$100,000 IRA charitable gifts provision opens up excellent 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.

IRA Charitable Donor Profiles

Introduction

In Division C -- the "Tax Extenders and Alternative Minimum Tax Relief Act of 2008" of H.R. 1424, Congress extended an excellent charitable planning opportunity for both 2008 and 2009. This act permits an IRA owner age 70½ or older to make a direct transfer to charity. The transfer may be up to \$100,000 in one year and this IRA rollover will exist for year 2008 and year 2009. Sec. 408(d)(8)(A).

Who Will Make IRA Rollover Gifts?

There are five donor profiles for IRA rollover gifts. The first are the convenience donors who 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, the Social Security recipient may reduce taxes with an IRA rollover gift. Finally, a standard deduction donor will benefit from a direct IRA to charity gift.

Convenience Donor

The majority of IRA owners delay taking IRA withdrawals until November or December each year. 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.

Convenience donors will contact their IRA custodians to arrange for the IRA charitable rollover. There is no charitable income tax deduction, but also no inclusion in federal taxable income. It is simply a very convenient way to help their 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 required withdrawals have 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.

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.

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.

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