e-newsletter
from the estate and succession planning team

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# Tax Free Distributions From IRAs To Charities

The Pension Protection Act of 2006 contains a provision that allows certain owners of traditional IRAs and Roth IRAs to exclude “qualified charitable distributions” of up to $100,000 a year from their gross income. In order for the be a “qualified charitable distribution,” the distribution must be (i) made on or after the date on which the owner of the IRA attains age 70½ and (ii) made by the custodian or trustee of the IRA directly to a charitable organization described in section 170(b)(1)(A) of the Internal Revenue Code (the types of organizations for which a taxpayer would ordinarily be entitled to a deduction of up to 50% of the taxpayer’s contribution base), with certain exceptions. The exclusion is available only for qualified charitable distributions made in 2006 and 2007.

The benefits of a qualified charitable distribution are that (i) the distribution from the IRA is excluded from the gross income of the owner, (ii) the excluded amount is not subject to the standard percentage limitation on charitable income tax deductions and (iii) the distribution is taken into account in satisfying the required minimum distribution for the year. High income individuals who itemize their income tax deductions benefit from the exclusion from gross income, because an increase in their gross income causes a phase-out of their itemized deductions. Charitable income tax deductions are limited to a percentage of a taxpayer’s adjusted gross income. Distributions that are excluded from gross income are equivalent to a 100% deduction. Taxpayers who would not be able to take a charitable deduction because they take the standard deduction and do not itemize their deductions also could benefit from the exclusion.

View the entire article written by David J. Akins, a member of our Estate and Succession Planning Team, below. And, as always, please do not hesitate to contact us if you have any questions.

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# TAX FREE DISTRIBUTIONS FROM IRAs TO CHARITIES

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## Overview

The Pension Protection Act of 2006 contains a provision that allows certain owners of traditional IRAs and Roth IRAs to exclude "qualified charitable distributions" of up to $100,000 a year from their gross income. In order for the be a "qualified charitable distribution," the distribution must be (i) made on or after the date on which the owner of the IRA attains age 70½ and (ii) made by the custodian or trustee of the IRA directly to a charitable organization described in section 170(b)(1)(A) of the Internal Revenue Code (the types of organizations for which a taxpayer would ordinarily be entitled to a deduction of up to 50% of the taxpayer's contribution base), with certain exceptions. The exclusion is available only for qualified charitable distributions made in 2006 and 2007.

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## Types of Plans That Qualify

The exclusion applies only to distributions from traditional IRAs and Roth IRAs. It does not apply to distributions from 401(k) plans, 403(b) annuities, defined benefit and defined contribution pension plans, profit sharing plans, Keogh plans, Simplified Employee Plans ("SEPS") or Savings Incentive Match Plans for Employees ("SIMPLE plans"). The owner of one of the other types of plans may be able to take advantage of the exclusion

by transferring funds from another type of plan, such as a 401(k) plan, to an IRA and, in turn, making a qualified charitable distribution from the IRA.

## Age Requirement

The owner of the IRA must have actually attained age 70½ in order for the distribution to qualify for the exclusion. The general requirement is that the owner of a traditional IRA must begin taking distributions during the year that the owner attains 70½ or by April 1 of the following year. For purposes of the exclusion, it is not enough that the distribution to the charity occur during the year the owner of the IRA attains 70½. The owner must attain age 70½ before a qualified charitable distribution can be made.

## Direct Transfers Only

The distribution must be made directly from the custodian or trustee of the IRA to the charity. A check made payable to the owner of the IRA and endorsed to the charity will not qualify for the exclusion.

## Types of Charitable Organizations

The types of charitable organizations described in section 170(b)(1)(A) that qualify for the exclusion are commonly referred to as public charities, such as churches, educational organizations, hospitals and medical research organizations. Entities known as donor advised funds and supporting organizations, although they are described in section 170(b)(1)(A), are specifically excluded.

## Distributions that Would Have Been Includable in Gross Income

A distribution qualifies for exclusion only to the extent that it would have been includable in the gross income of the owner of the IRA if the owner had received the distribution. Some individuals make non-deductible contributions to their traditional IRAs. These contributions are not taxable when they are withdrawn. Ordinarily, distributions from an IRA that received non-deductible contributions are treated as including a proportionate share of the taxable and non-taxable assets. A special rule applies to qualified charitable distributions, however. The qualified charitable distribution is treated as consisting of the taxable assets first, up to the aggregate amount of taxable assets. Thus, the amount of non-taxable assets available for distribution is not reduced, increasing the portion of future distributions that will not be taxable under the general rules applicable to distributions.

Most distributions from a Roth IRA are not included in the gross income of the owner in any event. Thus, a distribution from a Roth IRA directly to a charitable organization generally would not be a qualified charitable distribution. Under the general rules applicable to both IRAs, however, the distribution would not be includable in the gross income of the owner, and the owner would be entitled to a charitable income tax deduction, subject to the standard percentage limitations. Distributions from a Roth IRA

within the first five years after the Roth IRA is established are included in the gross income of the owner.  Thus, the exclusion would apply to such distributions from a Roth IRA directly to a charitable organization.

## Distribution Must Otherwise be Fully Deductible

The exclusion does not apply to any part of a distribution if the owner of the IRA receives a benefit in exchange for the distribution or does not receive sufficient substantiation of the gift.  Thus, if the owner of the IRA receives a dinner, tickets or other types of goods, services or benefits in exchange for the gift, the exclusion does not apply to any part of the distribution.  Furthermore, the exclusion does not apply to a distribution to a pooled income fund or to a charitable gift annuity, both of which provide a return to the donor.  The entitlement to the exclusion is subject to the same substantiation requirements as any other gift of cash.  Thus, the owner of the IRA must receive from the charitable recipient of the distribution a contemporaneous written acknowledgement of the gift.  The writing should include a statement that the owner of the IRA has not received, and will not receive, any goods or services in connection with the gift.

## Who May Benefit

Individuals who take the standard deduction and do not itemize their deductions cannot claim a charitable deduction.  They will benefit from the exclusion of the distribution from their gross income, which is essentially equivalent to a charitable deduction for 100% of a qualified charitable distribution.

For individuals who itemize their deductions, the deductions are phased out by 2% of the amount their adjusted gross income exceeds $150,500 ($75,250 for married taxpayers filing separately).  Medical and dental expenses are deductible only to the extent that they exceed 7.5% of a taxpayer's adjusted gross income and miscellaneous itemized expenses are deductible only to the extend that they exceed 2% of the taxpayer's adjusted gross income.  The exclusion of qualified charitable distributions from the gross income of the IRA owner avoids increasing the owner's adjusted gross income and, in turn, the floor on the amount of medical, dental and miscellaneous deductions that are allowed and potentially causing a phase out of all types of itemized deductions otherwise allowable.

Individuals cannot deduct charitable contributions in excess of 50% of their contribution base.  Individuals whose charitable deductions would otherwise be limited by the percentage limitation can benefit from qualified charitable distributions, 100% of which are excluded from their gross income.

If the income of an individual who receives Social Security benefits exceeds certain thresholds, the Social Security Benefits are subject to income tax.  Such individuals can benefit from making a qualified charitable distribution that is excluded from their gross income.

You should consult with your legal and tax advisers to determine if you qualify for a charitable IRA rollover and, if so, whether it would be more beneficial to you than other charitable giving initiatives.

The members of the Dean Mead Estate and Succession Planning Team are familiar with all aspects of IRA distributions and charitable giving, and are available to discuss the application of the charitable IRA rollover to your unique situation.

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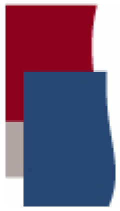


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