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Congressional change to IRA plans provides win-win for clients, charities

THE BUZZ

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Philanthropic taxpayers age 70½ and older should stop and think before taking the required minimum distributions from their individual retirement accounts.

Taxpayers who desire to make a donation to a charitable organization may now distribute up to $100,000 from an IRA directly to the charitable organization and the distribution will be considered tax-free. This is a significant benefit to taxpayers because the distribution does not have to be considered part of a taxpayer's income, translating into tremendous income tax savings.

History

The Pension Protection Act of 2006 provided a charitable rollover provision that allowed an annual exclusion from gross income up to $100,000 for "qualified charitable distributions" from an IRA. Without this law, withdrawals from IRAs to charitable organizations were considered taxable income.

In prior years, a taxpayer would report income on the required minimum distributions from an IRA and then take a charitable income tax deduction on donations made to charitable organizations. With the law, to the extent of $100,000 per year, the donation is treated as a tax-free distribution, thereby removing tax penalties, which would be as much as 60 percent.

Historically, the charitable rollover provision was enacted on a temporary basis and was originally set to expire on Dec. 31, 2007. Taxpayers did not know if the law was going to be extended or applicable in the year the charitable distributions were made.

However, in subsequent years, each time the provision was set to expire, Congress extended it. Unfortunately, the announcement that the law was extended or retroactive for a prior year was often made long after many taxpayers already took their required minimum distributions from IRAs. The most recent extension was made through Dec. 31, 2014.

Now permanent

Recently, however, this provision was made permanent. After much deliberation, on Dec. 18, 2015, Congress passed the Protecting Americans From Tax Hikes Act. PATH made the IRA charitable rollover provision, as well as various other tax benefits, permanent.

Now, rather than having to wonder if charitable donations will result in significant taxes and rely on Congress extending the provision, taxpayers can make charitable distributions without concern. When properly administered, the donation is excluded from the taxpayer's gross income. However, the distribution does not qualify for charitable income tax deduction.

There are several requirements associated with this benefit. As mentioned, the taxpayer must be at least 70½ years old, and the donation must satisfy the following conditions:

- May not exceed $100,000 per year.
- Must be to a qualifying charitable organization.
- Must be made directly from the IRA to the charity.
- Must be an outright gift.
- Must be otherwise taxable.

IRAs only

First, the charitable rollover provision requires the distribution to be made from a traditional IRA or Roth IRA. Therefore, simplified employee plans, savings incentive match plans for employees, plans under Internal Revenue Code Sections 403(b) and 401(k), profit-sharing plans and pension plans do not qualify. However, taxpayers who do not have IRAs can transfer funds from, for example, an existing 401(k) plan into a newly established IRA and then make distributions.

The IRA charitable rollover provision is advantageous to both philanthropic taxpayers as well as charitable organizations. Taxpayers now have a reliable method in which to make charitable donations without incurring harsh tax penalties.

Directly to charity

The distribution must be made directly to the charity by the IRA plan administrator. Therefore, the check must be made payable from the IRA account to the charity. If a check is made payable to the taxpayer and then endorsed to the charity, it will not qualify.

Bona fide charities

The donation must be made to a "qualifying charitable organization." Qualifying organizations, described in IRC Section 170(b)(1)(A), are typically public organizations such as churches, hospitals, museums and educational organizations. Distributions cannot be made to a donor-advised fund, supporting organization, charitable trust or private nonoperating foundation.

Outright gift

The donation must be an outright gift. This means that no benefit, such as goods or services, may be received by the taxpayer in return for the distribution. While some minor benefits, such as public recognition or token gifts, may be disregarded pursuant to IRC Section 170, if the benefit is not disregarded it causes the entire distribution — not just the benefit portion — to be disqualified.

Examples of non-disregarded benefits include tickets to events or memberships with substantial inclusions. Additionally, to constitute a qualified charitable distribution, the taxpayer must obtain a written acknowledgement from the charity indicating that no goods or services were received in return for the contribution.

Otherwise taxable income

A distribution will be considered a qualified charitable distribution only if the distribution would have otherwise been included in the taxpayer's gross income if such distribution had been withdrawn. Thus, only the taxable portion of any IRA distribution can qualify as a qualified charitable distribution.

However, the law provides that distributions from an IRA to charity are deemed to come first from the taxable portion of the IRA account. This causes the distribution to be comprised of the maximum amount of taxable income.

The IRA charitable rollover provision is advantageous to both philanthropic taxpayers as well as charitable organizations. Taxpayers now have a reliable method in which to make charitable donations without incurring harsh tax penalties.

Charitable organizations receive much needed funding to assist in achieving their important philanthropic purpose. Last, but not least, estate planners no longer have to worry whether the charitable rollover provision will be extended year after year.

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