

Insights

Individual Retirement Plans

Charitable IRA Rollover Provision Extended Through 2009



The Emergency Economic Stabilization Act (EESA) of 2008 (the "Bailout Bill") retroactively reinstates through 2009 the charitable IRA direct rollover provision originally enacted by the Pension Protection Act of 2006. The new legislation makes no changes to the charitable IRA rollover provision enacted by the Pension Protection Act of 2006. Thus, the IRS' interpretive rulings of the Pension Protection Act of 2006 version of the charitable IRA rollover provision should apply as well to the extended legislation.

As originally enacted, the Pension Protection Act of 2006 allowed for an exclusion from gross income of up to \$100,000 per IRA owner per year from a traditional IRA or Roth IRA for a "qualified charitable distribution" made during 2006 and 2007 by an IRA owner who has attained age 70½ on the date of distribution. The Emergency Economic Stabilization Act, signed October 3, 2008, retroactively extends this provision for all of 2008 through the end of 2009. Thus, an IRA owner who has attained age 70½ is allowed to directly transfer up to \$100,000 from a traditional IRA or a Roth IRA in 2008 and 2009 to organizations that qualify under §170(b)(1)(A) i.e. public charities.

Many individuals would like to use their IRAs to make charitable gifts while they are alive. These individuals assume that they can withdraw money from an IRA and donate that amount to charity offsetting the taxable distribution with a charitable deduction. In many cases this is not possible. First, IRA withdrawals before age 59½ are subject to a 10% early withdrawal penalty. There is no exception to the 10% early withdrawal penalty for giving the IRA distribution to charity.

Second, there is a limit on the amount an individual may deduct as a charitable deduction. Generally, an individual's income tax charitable deduction for a cash contribution is limited to 50% of the individual's adjusted gross income (AGI). A sizable distribution from an IRA to a charity may not be fully deductible due to AGI limits. Third, some states (e.g., Massachusetts) do not allow an income tax charitable deduction, so state income tax may be due on the contribution of an IRA distribution to charity. Finally, a large IRA distribution must be recognized as taxable income. This increases the individual's AGI, resulting in the loss of several valuable income tax deductions and exemptions which are tied to the amount of an individual's AGI (e.g., the medical deduction, a casualty loss deduction, the taxation of social security benefits, personal exemptions and miscellaneous itemized deductions).

The extension of the charitable IRA Rollover provisions of the Pension Protection Act of 2006 allows IRA owners and beneficiaries over the age of 70½ to satisfy their charitable intentions by making distributions from their IRAs directly to charity without having the IRA distribution included in their income. This offers an extremely tax-efficient way of making a lifetime charitable gift.

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The Importance of a “Qualified Charitable Distribution”

To qualify, the distribution from a traditional IRA or Roth IRA must be a “Qualified Charitable Distribution” (QCD). The requirements are as follows:

1. The distribution can only be made from a traditional IRA or a Roth IRA. A QCD cannot be made from a 401(k) plan, a 403(b) plan, a defined benefit plan, a defined contribution/profit sharing plan, a Keogh plan, a simplified employee pension (SEP), or a SIMPLE plan. However, Notice 2007-7, 2007-5 I.R.B 395 makes an exception for SEPs and SIMPLEs. A QCD may be made from a SEP or a SIMPLE as long as the SEP or SIMPLE is not an “ongoing” SEP or SIMPLE; an “ongoing” SEP or SIMPLE is one where an employer contribution is made for the plan year ending with or within the IRA owner’s tax year in which the charitable contribution would be made. Thus, a QCD can be made from an inactive SEP or SIMPLE.
2. The QCD must be made on or after the IRA owner has attained the age of 70½.
3. The QCD must be made directly by the IRA administrator to the charity. In other words, the IRA owner cannot take a distribution from the IRA and then contribute the distribution to the charity. However, a check that is payable to a charity and that is sent to the IRA owner for delivery to the charity will be treated as a direct payment. Notice 2007-7.
4. The QCD must be made to an organization as described in §170(b)(1)(A). Thus, a QCD may not be made to a donor advised fund (as defined in §4966(d)(2)) or a supporting organization (as defined in §509(a)(3)).
5. The QCD must otherwise fully qualify for an income tax charitable deduction. As a result of this requirement, a charitable gift annuity, pooled income fund and a charitable remainder trust are ineligible to receive a QCD. No split interest gifts of any type will qualify as a QCD. To quote the Joint Committee on Taxation’s Technical Explanation of

the Pension Protection Act of 2006, “The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.”

6. The distribution must have been taxable if distributed to the plan participant.

Administration Issues

Requirement of a “Contemporaneous Written Acknowledgement”

The charity must furnish a “contemporaneous written acknowledgement” (the Treasury regulation’s fancy name for a thank you note) to the donor. See Treasury regulation 1.170A-13(f). The IRA administrator should note the donor’s name on the transmittal of the check or wire transfer to the charity so that the charity can identify the donor and furnish the donor with a “contemporaneous written acknowledgement.”

No Quid Pro Quo

The charity cannot furnish any “quid pro quo” for the contribution. Thus, the charity should make sure that nothing of value (e.g., free dinner thanking donors, tickets to college football game, etc.) is exchanged in connection with the gift of the IRA as that would make the exclusion inapplicable with respect to any part of the IRA distribution. It is recommended that the contemporaneous written acknowledgement (thank you note) include a statement from the charity that no consideration was received in return for the donation of the IRA distribution.

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A QCD Counts Towards the IRA Owner's MRD

The QCD counts as part of the IRA owner's minimum required distribution. The IRA distribution is not includible in income.

No Income Tax Deduction

An income tax charitable deduction cannot be taken for the QCD.

Distributions In Excess of \$100,000

The amount of the direct transfer that may be excluded from income is limited to \$100,000 per taxpayer per year. If more than \$100,000 is transferred by an IRA owner to a charity, there is no carryover to a future year. The amount of the contribution in excess of \$100,000 is taxable income and a charitable deduction can be claimed if the IRA owner itemizes his or her deductions.

Special Rule for IRAs with Nondeductible Contributions

There is a special rule for IRAs that include nondeductible contributions. If an IRA owner has an IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income if the aggregate balance of all IRAs having the same owner were distributed during the same year. In other words, taxable distributions are considered distributed first before any nontaxable distributions. This rule is favorable to the taxpayer – it will increase the portion of after-tax money remaining in his IRA and reduce the tax owed on future IRA distributions. In determining the amount of subsequent IRA distributions includible in income, proper adjustments should be made to reflect the amount treated as a qualified charitable distribution under the special rule.

How Late in the Year Can a Distribution Be Made?

IRA owners should consult with the IRA administrator to determine how late in December the IRA administrator will allow an IRA owner to make a QCD to a charity.

Can an IRA Beneficiary Make a QCD?

IRA beneficiaries, as well as IRA owners, are allowed to make QCD. (Notice 2007-7.) The charitable distribution will only be qualified if the distribution is made on or after the date the IRA owner or beneficiary attains age 70½. Thus, a beneficiary of an IRA can make a QCD if the beneficiary is over age 70½ when the distribution is made in 2008 or 2009.

Can Each Spouse Make a QCD?

For married couples, if each spouse has his or her own IRA, each spouse can transfer up to \$100,000 from their own IRA to charity as long as each spouse meets all of the QCD requirements. Notice 2007-7. However, gift-splitting is not allowed for charitable distributions. An IRA owner cannot make a distribution of \$200,000 from his IRA and treat half of the distribution as being made by him and half being made by his spouse. Notice 2007-7.

Will a Distribution from a Checkbook IRA Qualify?

A distribution from a checkbook IRA to a qualified charity will qualify as a QCD. Notice 2007-7 says that a check from an IRA payable to a charity and delivered by the IRA owner to the charity will be considered a direct distribution from the IRA custodian.

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Can a QCD Satisfy a Pre-existing Pledge?

A charitable distribution to a charity where the IRA owner has an outstanding pledge will be treated as a QCD and not as a prohibited transaction. (Notice 2007-7.) The Department of Labor (which has interpretive authority over the self-dealing rules) has advised the IRS that a QCD made by an IRA trustee directly to a qualifying charity will be treated as received by the IRA owner (i.e., it will not constitute self-dealing, a prohibited transaction).

Is a QCD Subject to Income Tax Withholding?

A QCD is not subject to income tax withholding. The IRA owner requesting the QCD is deemed to have elected out of withholding under §3405(a)(2).

How is a QCD Reported for Income Tax Purposes?

The instructions to Form 1040, (for 2008 returns see p. 23) tells how to report a QCD. The IRA custodian will report all distributions from the IRA on a Form 1099-R as taxable distributions to both the IRA owner and the IRS. The IRA owner will report all of the IRA distributions on line 15a of the Form 1040 but only the taxable distributions on line 15b. This is similar to the tax reporting for IRA rollovers (i.e., only the taxable portion of the distribution is shown on line 15b). The QCD will not be disclosed on Schedule A, the schedule where itemized deductions, including charitable gifts, are reported.

This method of tax reporting relieves the IRA custodian from determining whether a distribution qualifies as a QCD. The IRA custodian simply reports the entire distribution as taxable. The burden is on the IRA owner to determine whether the distribution qualifies as a QCD and to report it accordingly. For example, if the IRA owner, who is over age 70½ took a \$5,000 distribution from his IRA in 2008 and had the IRA custodian send a qualifying charity a check for \$2,000 of the \$5,000 as a QCD, the IRA custodian would report a taxable distribution from the IRA on Form 1099-R of \$5,000 and the IRA owner would report the total \$5,000 distribution on line 15a of his 1040 and \$3,000 on line 15b as a taxable distribution. The \$2,000 QCD would not appear on Schedule A, Itemized Deductions.

Conclusion

The extension of the IRA charitable rollover provision of the Pension Protection Act of 2006 provides taxpayers over 70½ with a very important opportunity to make a tax-efficient lifetime gift from an IRA. Given the significant decline in the stock market in 2009, individuals who in the past have made gifts of appreciated securities now have an additional way to make a tax-efficient gift to charity.

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