



Diocese of Providence

THE PENSION PROTECTION ACT OF 2006—A NEW TAX INCENTIVE FOR CHARITABLE ROLLOVERS

On Aug. 17, 2006, President Bush signed H.R. 4, the Pension Protection Act of 2006, into law. This legislation provides your clients with tax incentives for charitable rollovers if they are age 70½ or older.

These clients will now be able to make outright gifts using funds from their IRAs without any undesirable tax effects. Prior to this law, if clients wanted to make a gift to charity using funds from their IRA, they would have to first withdraw the desired amount, then deposit the funds into a checking account and write a corresponding check to the charitable organization. This would force the client to include any amount withdrawn from the IRA in his or her gross income. The client could then take a charitable deduction for the gift—but only up to 50 percent of his or her adjusted gross income. In effect, this caused some clients to pay more in income taxes than they would have if they hadn't made a gift at all. For example, a client withdraws \$50,000 from an IRA and gives it to charity. Prior to the gift, the client had \$20,000 in adjusted gross income. Now the total adjusted gross income is \$70,000, but the donor can deduct only 50 percent, or \$35,000, of the \$50,000 gift.

Under the recent law, clients can make these IRA gifts without including the IRA distribution in their gross income. They will not, however, be able to deduct the distribution as an itemized deduction.

CHARITABLE ROLLOVER PROVISIONS

- Clients must be age 70½ or older on the date the distribution is made.
- Gifts equalling as much as \$100,000 can be made now until Dec. 31, 2007.
- Clients must make the gift via a direct transfer to a public charity and not take receipt of the funds.
- The funds must come from an IRA or Rollover IRA. Other types of retirement accounts including SEPs, SIMPLEs, TSAs or 403(b)s, 401(k)s, and pension or profit sharing accounts are not eligible. If clients who are age 70½ or older have funds in these other retirement accounts, they may be able to move a portion of that money into a Rollover IRA; then a charitable rollover could be made from the Rollover IRA. For the best results, make sure these transactions occur on separate days.
- Gifts to charitable trusts, donor advised funds and supporting organizations are not eligible for these tax benefits. [See IRC 408(d)(8)(B)(i)]. This type of IRA gift also cannot be made in exchange for a charitable gift annuity.
- Gifts under this provision are not taken into account in determining the client's deduction for other charitable contributions. Since IRA gifts under the

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Charitable Rollover Requirements

- Individual must be age 70½ or older.
- The gift is not more than \$100,000.
- The gift must be made on or before Dec. 31, 2007.
- Funds must be transferred directly from an IRA or Rollover IRA.
- The gift recipient must be a public charity. This excludes gifts made to charitable trusts, donor advised funds and supporting organizations.
- The gift must be outright—there can be no quid pro quo. It cannot be made in exchange for a charitable gift annuity or other life income plan.

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new law are not deductible, the amount given under this provision has no bearing on the amount of other charitable gifts given during the calendar year.

- Clients cannot receive an economic benefit or quid pro quo from the gift or else the entire gift is not an eligible charitable rollover. (See the Joint Committee on Taxation's technical explanation of H.R. 4, Page 267.)
- Further, the charity must provide sufficient substantiation to the donor. Appropriate substantiation will likely include statements to the following:
 - The IRA funds were not contributed to a donor advised fund, a supporting organization, a charitable trust or a charitable gift annuity.
 - The gift was from an IRA.
 - The gift was transferred directly from the donor's IRA to the charitable organization.
 - It is the donor's intention that this gift qualifies as a charitable distribution from the IRA under IRC 408(d)(8). There should be no statements that the gift is deductible.

WHO CAN BENEFIT

Clients who do not itemize their federal tax deductions can benefit greatly from H.R. 4. Without this law, they would have to pay taxable income on their IRA withdrawal, and yet they couldn't deduct it as a charitable gift because they take the standard deduction.

Clients with higher incomes (single or married filing jointly with income greater than \$150,500; married filing separately with incomes greater than \$75,250) causing them to lose part of their itemized deductions (i.e., a 2 percent phaseout) will also benefit because the distribution from the IRA will not cause their AGI to inflate.

Clients who live in states that do not allow state income tax deductions for charitable

gifts will also benefit. Without the law, these clients would have to claim the IRA distribution as taxable income on their state and federal returns, and could deduct it on the federal return—subject to the AGI limits—but wouldn't receive a state income tax deduction for the gift. Thus, they would pay more in state income tax.

HOW CLIENTS CAN MAKE GIFTS

Clients must contact their IRA administrator for the forms necessary to transfer gifts directly to public charities. It is important that the funds are transferred directly from the IRA to the charitable organization. The client cannot receive the funds first and then make a gift using the proceeds from the distribution. It will be up to each IRA administrator to determine what particular forms or procedures will be needed to process an IRA gift. Expect different procedures with different institutions. Be patient with some IRA administrators who may not be as familiar with handling these transactions.

QUESTIONS AND ANSWERS

Q: *Can clients use their required minimum distributions to make a gift?*

A: Yes, as long as the required minimum distribution is less than or equal to \$100,000 in 2007. This is a great opportunity for clients to avoid receiving the required distribution and paying income taxes on it. They can ask the IRA administrator to transfer the distribution directly to the qualified charitable organizations of their choice.

Required distributions from IRAs must begin no later than April 1 of the year following the year the IRA holder turns age 70½. An account holder turns age 70½ six months after his or her 70th birthday. The distributions are taxed to the account holder as ordinary income. Therefore, if an IRA gift can qualify as

part or all of the IRA holder's required distribution, it means he or she will have less taxable income for the year.

Q: I have some clients who would like to give more than \$100,000. How can they do that?

A: The legislation allows clients to make a gift in the 2006 tax year and the 2007 tax year. So, if a client made a \$100,000 gift before Dec. 31, 2006, he or she can give another \$100,000 in 2007. A spouse aged 70½ or older with his or her own IRA is governed by the same limits over the same period.

Q: I have clients who have already named a charitable organization as the beneficiary of their IRA. What are the benefits to them if they make a gift now instead of at death?

A: If clients have already named a qualified charitable organization as a full or partial beneficiary of their IRA, there are no tax differences to them if they give up to \$100,000 per year as a charitable rollover. By naming the charitable organization as the beneficiary at death, they have avoided income and estate taxes on those funds. By making an outright gift up to \$100,000 now, they are also making this gift free of income and estate taxes. The benefit to them may not be immediate financial rewards, but rather the ability to enjoy their philanthropy while they are still alive. The downside, of course, is that their retirement nest egg is smaller than before.

Q: Can a client give his or her entire IRA?

A: Yes, as long as it equals \$100,000 or less. If a client's IRA is valued at more than \$100,000, he or she can make a partial direct transfer from the account.

Q: Could a client give to more than one charitable organization?

A: Under the law, a client can give a maximum of \$100,000 in 2007, and that amount can be divided among several charitable organizations. A client could

give 10 organizations \$10,000 each, give one organization \$100,000 or any other combination.

HIGHLIGHTS OF OTHER CHARITABLE GIFT PROVISIONS

Charitable Deduction for Contributions

of Food Inventory—This legislation extends the provision provided by the Katrina Emergency Tax Relief Act of 2005 so that any taxpayer, whether a C corporation or not, engaged in a trade or business, is eligible to claim the enhanced charitable deduction for contributions of food inventory. The deduction is the lesser of:

- (1) the taxpayer's basis plus one-half of the difference between fair market value and basis, and
- (2) twice the taxpayer's basis in the contributed inventory.

For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations or partnerships (other than non-C corporations) from which contributions of apparently wholesome food are made.

The deduction for food is only available if the food is "apparently wholesome food," defined as food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws and regulations even though the food may not be readily marketable because of appearance, age, freshness, grade, size, surplus or other conditions.

This provision is effective for donations made after Dec. 31, 2005, and before Jan. 1, 2008.

Adjustment of Cost Basis to Stock of S Corporation Contributing Property—

For charitable contributions made by an

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If your clients are contemplating making a gift to our organization, please let us know. We would be happy to assist in the transaction and have the opportunity to show our gratitude.

For the complete technical explanation of H.R. 4, the Pension Protection Act of 2006, go to www.house.gov/jct/x-38-06.pdf.

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S corporation, the amount of a shareholder's basis reduction in the stock of the corporation will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property. Prior to this law, the basis reduction was determined by the value of the charitable contribution, not the shareholder's adjusted basis.

This provision is effective for contributions made in taxable years beginning after Dec. 31, 2005, and before Jan. 1, 2008.

Qualified Conservation

Contributions—The provision raises the charitable deduction limit from 30 percent of adjusted gross income to 50 percent of adjusted gross income for qualified conservation contributions by individuals. The charitable deduction limit is raised to 100 percent of adjusted gross income for eligible farmers and ranchers, provided that such contributions include a restriction that the property remains generally available for agriculture or livestock production. A qualified farmer or rancher is a taxpayer whose gross income from the trade or business of farming is greater than 50 percent of his or her gross income

for the year. The provision allows a taxpayer to carry forward the deduction for 15 years instead of five years.

A qualified conservation contribution is a contribution of qualified real property to a qualified organization exclusively for conservation purposes. Conservation purposes include:

- (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public;
- (2) the protection of a relatively natural habitat of fish, wildlife or plants, or similar ecosystems;
- (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated federal, state or local governmental conservation policy; and
- (4) the preservation of a historically important land area or a certified historical structure.

This provision is effective for contributions made in taxable years beginning in 2006 and before Jan. 1, 2008.

The information in this publication is provided for general information purposes only. The application of laws discussed in this publication may vary from state to state.

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WHERE CAN YOU FIND THE BEST RESOURCE FOR TECHNICAL GIFT PLANNING INFORMATION?

Our site offers a complete array of information and tools for your use as you advise your clients on their gifts to Catholic Foundation of Rhode Island—Bequest Language, Gift Calculator, and a Professional Advisors Reading Room that covers a full spectrum of planned giving and estate planning articles written by national experts.



www.providencediocese.org/foundation.htm