

Continued from Page 3
The calculations are as follows:

\$700,000	Value of IRA owned by deceased at death
–\$315,000	Federal estate taxes due assuming a 45 percent marginal bracket
= \$385,000	Net amount subject to federal income tax ⁶
× 35%	Federal income tax marginal bracket of child
= \$134,750	Federal income tax payable by child
Total taxes:	\$315,000 + \$134,750 \$449,750 or 64 percent
Net to child:	\$700,000 – \$449,750 \$250,250 or 36 percent (this example does not include the effect of state taxes)

The better tax strategy, then, is to transfer a decedent's IRD assets to a tax-exempt charitable organization or to a tax-exempt charitable remainder trust, and transfer

⁶ Technically the entire amount is subject to federal income tax, but the beneficiary can deduct the estate taxes paid as an itemized income tax deduction, not subject to the 2 percent floor. IRC Section 691(c).

property receiving a stepped-up cost basis to taxpaying family members.

HOW TO MAKE A CHARITABLE BEQUEST OF AN IRA

The best method to make a charitable bequest of IRA assets and avoid all estate and income taxes is to name the charitable organization as the beneficiary on the IRA beneficiary designation forms.

Although this wasn't always the case, now during the IRA owner's lifetime, the minimum distributions are the same even when a charitable organization is named as beneficiary. At death, however, the administrator should "cash out" the charitable organization's share of the IRA before Sept. 30 of the year that follows the year of death. By doing so, it will leave only noncharitable beneficiaries and will give them the option to do a "stretch IRA." Overall, this strategy permits a charitable organization to be a beneficiary of part of any IRA without causing accelerated distribution problems to other beneficiaries.

Please do not hesitate to contact us if we can be of any assistance in helping you facilitate a charitable donation from an IRA to our organization by the end of 2007.

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.

CATHOLIC FOUNDATION OF RHODE ISLAND

Diocese of Providence

Sandra Sebring

Associate Director, Planned and Major Gifts
Office of Stewardship & Development
One Cathedral Square • Providence, RI 02903
(401) 277-2121
Fax: (401) 277-2120
E-mail: ssebring@dioceseofprovidence.org



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Diocese of Providence

BEST CHARITABLE OPTIONS FOR IRAS

Millions of Americans have individual retirement accounts (IRAs) subject to complex taxation for withdrawals and distributions made during their lifetimes. Fortunately, these assets make tax-efficient charitable gifts upon the IRA owner's death. Plus, under the Pension Protection Act of 2006, lifetime charitable gifts are temporarily attractive options.

LIFETIME DISTRIBUTIONS

Since IRAs grow on a tax-deferred basis, the government does not realize any revenue until funds are withdrawn. To ensure that these funds are not deferred in perpetuity, the IRS established rules requiring mandatory distributions when an IRA owner reaches a certain age. Then he or she is subject to the required minimum distribution (RMD) rules and must begin receiving amounts from all of his or her IRAs¹ or face a 50 percent IRS penalty tax on the amount that should have been distributed, but was not. The IRA owner can always withdraw more than is required, but must take the minimum to avoid the penalty.

The required beginning date for an IRA owner to receive the first distribution is April 1 of the year following the year the account holder reaches age 70½. This is the first distribution for the year the account holder reaches age 70½.

¹ Minimum distributions are not required from Roth IRAs during the account owner's lifetime.

The second required distribution is then due by Dec. 31 of that same year, and each subsequent year's distribution is due by Dec. 31. If the IRA owner delays receipt of the first distribution until April 1 of the year after turning 70½, two distributions must occur in that same calendar year, which may not be wise from an income tax perspective.

The amount of the required minimum distribution is determined by the Uniform Lifetime Table (see Table 1), without regard

Continued on Page 2

Table 1: RMD Uniform Lifetime Table

To figure the required distribution, find the age of the IRA owner and the corresponding distribution period. Then divide the value of the IRA by the distribution period.

Age Of Retiree	Distribution Period (In Years)	Age Of Retiree	Distribution Period (In Years)
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115	1.9

Example: An IRA owner's date of birth is May 1, 1937, and he turns age 70½ on Nov. 1, 2007. His IRA balance as of Dec. 31, 2006, is \$1 million. His first distribution (for the year he turns age 70½) is due by April 1, 2008, and the second distribution is due by Dec. 31, 2008. The first minimum distribution is calculated as follows: \$1,000,000 ÷ 27.4 = \$36,496. The second distribution is determined by the Dec. 31, 2007, account balance, which is then divided by a factor of 26.5.

Continued from Page 1

to who is named as the beneficiary. The exception to this is if the IRA owner is married to someone who is more than 10 years younger than himself or herself and has named that younger spouse as the sole beneficiary.

While the U.S. Treasury has simplified the rules for determining minimum distribution amounts, it has also aided the ability to enforce the distribution rules. Every IRA administrator is required to report to the IRA owner and the IRS the amount of the required minimum distribution for each calendar year.

DISTRIBUTIONS UPON DEATH

Minimum distributions are required even after the death of the IRA holder. The amount of the distribution depends on whether the owner died prior to or after his or her required beginning date and if the account listed a designated beneficiary or not.² See Table 2 for the requirements.

Only a surviving spouse can roll over an inherited distribution to his or her own IRA, called a spousal rollover IRA, and further delay receiving required distributions until his or her own required beginning date; all other beneficiaries must take distributions and are taxed according to the rules in Table 2.

Beneficiaries who are not designated beneficiaries should have their shares distributed to them by Sept. 30 of the year following the year of the IRA holder's death. This allows the remaining designated beneficiaries to stretch out the receipt of distributions over their lifetimes (i.e., a stretch IRA) and, hence, defer the income taxes. Of course, the beneficiary always has the option to speed up his or her distributions or to take the balance in a lump sum at any time.

LIFETIME CHARITABLE GIFTS

To make a charitable gift from an IRA, the IRA owner must request a distribution from the IRA, deposit the distribution and then write a check for the amount of the charitable gift. The withdrawal is subject to ordinary income tax and, of course, a 10 percent penalty tax if the IRA owner is younger than age 59½.

As a second transaction, the IRA owner can then take a charitable contribution deduction for the gift, but only if he or she itemizes his or her deductions. The deduction is subject to a ceiling of 50 percent of the adjusted gross income (AGI). Because of this limitation, if the IRA owner withdraws too much from the IRA, it can cause him or her to pay more in income taxes than if there was no gift at all.

Example: Suppose an IRA owner's AGI is \$25,000. Additionally, the IRA owner

Table 2: Required Minimum Distributions Upon Death

	Death Occurs Before Required Beginning Date	Death Occurs On or After Required Beginning Date³
Designated beneficiary	Distributions may be made over the life or life expectancy of the designated beneficiary and begin within one year of the IRA owner's death. ⁴	Distributions may be made over the longer of the beneficiary's life expectancy or the remaining life expectancy of the IRA owner using the age of the owner in the year of his or her death.
No designated beneficiary	The entire interest must be distributed by Dec. 31 of the fifth year after the IRA owner's death.	Distributions may be made over the deceased IRA owner's remaining life expectancy using the age of the owner in the year of his or her death.
Spouse beneficiary	The beneficiary can elect a spousal rollover or keep the account in the name of the deceased IRA owner.	The beneficiary can elect a spousal rollover, but must receive any outstanding RMD of the deceased spouse due in the year of his or her death.

² Designated beneficiary refers to a person—not the owner's estate, a charity or certain trusts.

³ Designated beneficiary is determined as of Sept. 30 of the year after death.

⁴ Nonspouse beneficiary distributions must begin by Dec. 31 of the year immediately following the calendar year in which the IRA owner died. The nonspouse beneficiary's life expectancy is calculated as of his or her birthday in the year following the year of the IRA owner's death—reduced by one for each year thereafter.

withdraws \$45,000 from an IRA and writes a check to charity for \$45,000. The IRA owner now has \$70,000 of AGI and can deduct a maximum of \$35,000 in the current tax year with a five-year carryforward for the \$10,000 excess and unused deduction.

Hence, making a charitable gift from an IRA during the IRA owner's lifetime is not the most tax-efficient gift asset to use. A better scenario is to make lifetime charitable gifts using appreciated assets like marketable securities held for more than one year. In this regard, long-term capital gains tax can be avoided and the full fair market value of the securities can be deducted as an itemized deduction—with no additions to income.

QUALIFIED CHARITABLE DISTRIBUTION

To avoid some of the inherent problems with making lifetime charitable gifts from IRAs, Congress enacted the Pension Protection Act of 2006, which allows IRA owners aged 70½ or older to use their IRAs⁵ to make lifetime gifts to qualified charitable organizations—called a qualified charitable distribution or QCD—without claiming the amounts taken from the IRAs as taxable income. An IRA owner, however, also may not use the amount given to charity as a charitable contribution deduction on the federal income tax return. The ceiling on the amount allowed under this provision is \$100,000 in 2007 (if the IRA owner made a gift in 2006, the limit was also \$100,000 for that year). A spouse with his or her own IRA who is also age 70½ or older at the time of the gift

may also contribute up to \$100,000 in 2007 as well as in 2006.

A client who doesn't need his or her required minimum distributions can transfer those payments directly to an eligible organization and will not have to pay income tax on the required distributions as long as their IRA gifts total \$100,000 or less for the year.

Be sure the IRA custodian sends the funds electronically or by a check made payable to the charitable organization. If the custodian makes the check payable to the donor and the donor deposits it into his or her bank account and writes a personal check for the charitable gift, the donor will not be eligible for the special tax breaks.

Supporting organizations, private foundations, charitable gift annuities, donor advised funds and charitable trusts are not eligible recipients of these funds. Without further legislative action, this provision of the Pension Protection Act expires Dec. 31, 2007.

BEST CHARITABLE GIFTS AT DEATH

Whereas lifetime gifts are best made with appreciated stock, charitable bequests are best made with IRAs and other assets that produce income in respect of a decedent (IRD). In simplified terms, IRD is an inherited payment that would have been taxable income to the decedent had the decedent received it before he or she died. IRD is an important exception to the general rule that inherited property is exempt from income tax. When a person inherits IRD, he or she must pay the income tax that the decedent never paid. Further, these assets are subject to estate taxes. The largest source of IRD in an estate is likely to be a retirement plan account or an IRA.

To illustrate the effect of income and estate taxes on an IRA, assume a \$700,000 IRA is left to the deceased owner's child.

Continued on Page 4

Income in respect of a decedent is an important exception to the general rule that inherited property is exempt from income tax.

⁵ If a client has a 403(b), 401(k) or other type of qualified retirement plan, consider transferring a portion of those funds to a Rollover IRA and subsequently transacting a QCD from the IRA. Note, however, that required distributions taken from the qualified retirement plan are not eligible to move to a Rollover IRA and therefore will not enable the IRA owner to use the required minimum distributions from the qualified retirement plan as a QCD.