



# IRAs

## Tax-Free Direct IRA Payments to a Charity

Questions & Answers

## Purpose

The purpose of this brochure is to explain a new charitable contribution federal income tax law which will benefit both qualifying charities and certain IRA accountholders. The authority for this new law is the Pension Protection Act of 2006, which was signed into law on August 17, 2006. This new law will primarily benefit traditional IRA accountholders; however, certain distributions from Roth IRAs are also allowed.

## What is the benefit of the new law?

In general, a person age 70½ or older will be able to direct his or her IRA custodian to withdraw an amount of up to \$100,000 from his or her IRA and have such proceeds sent directly to a qualifying charitable organization. The distribution will be tax free if certain rules are met.

Under the existing tax rules, approximately two-thirds of tax filers use the standard deduction and are unable to claim a deduction for their charitable contributions. There are many people over age 70½ who use the standard deduction. There will now be an incentive for these individuals to withdraw funds from their IRA, because excluding an amount from one's income is the equivalent of claiming a tax deduction.

## Is there a time period within which the qualified charitable contribution must be made?

Yes, this new law is effective with respect to distributions made in tax years beginning after December 31, 2005, and by December 31, 2007, unless a subsequent law would be passed to extend it.

## What requirements must I meet in order to take advantage of this charitable contribution law?

1. You must be age 70½ or older.
2. You must have a traditional or Roth IRA.
3. Your charitable contributions must otherwise be deductible. A distribution qualifies to be a qualified charitable distribution only if a deduction for the entire distribution would be allowable to be deducted under Code section 170 (but you are able to disregard the percentage limits). **Caution:** You receive the tax-free charitable contribution treatment only if the entire amount would have qualified as a charitable deduction. Thus, if the contribution amount is reduced because of a benefit received by you in exchange, or because the custodian does not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

4. The distribution, but for this rule, must otherwise have been required to be included in your gross income. The withdrawal of basis (i.e. nondeductible contributions) from a traditional IRA is not includable in income, and consequently, such withdrawal does not qualify as a tax-free charitable contribution. If the withdrawal from a Roth IRA will not be taxed because it is either the withdrawal of basis or because the distribution is a qualified distribution, such withdrawal does not qualify as a tax-free charitable contribution.
5. Payment, no matter in what form (electronic transfer, check, etc.), must be made directly from the IRA to the qualifying charitable organization. The instrument used for payment must not be negotiable by the IRA accountholder.

### **Is there a limit on the amount which can be contributed to a charity each year?**

Yes, you may contribute up to a maximum of \$100,000 each year to a qualifying charity for years 2006 and 2007.

### **May my spouse and I both make this type of contribution?**

If you and your spouse have separate IRAs, you may each contribute the maximum of \$100,000.

### **If I have two or more IRAs, may I contribute \$100,000 from each one?**

No, the maximum you can contribute per year is \$100,000. This maximum is "per person," NOT "per IRA."

### **Will the amount I contribute under this distribution option count toward my required minimum distribution (RMD) for the year?**

Yes, any amount distributed as a qualifying charitable contribution in 2006 and 2007, will be counted toward your RMD for the applicable year.

### **May I deduct this contribution on my Schedule A as a charitable contribution?**

No, any amount which you donate to charity under this new charitable contribution rule cannot be deducted as an itemized deduction for that year on Schedule A of your Form 1040 income tax return.

## **If I took my RMD prior to enactment of the Pension Protection Act, can I make a tax-free charitable contribution using my RMD funds now?**

No. There is no authority stating that this provision of the Pension Protection Act is retroactive to any date earlier than August 17, 2006. You may, however, make a tax-free charitable contribution using additional IRA funds, up to the \$100,000 limit.

## **Would it benefit me to have the distribution come from my Roth IRA rather than my traditional IRA?**

Roth distributions are always tax free if the 5-year rule has been met and the accountholder is age 59½ or older. Therefore, if you meet those requirements, you will not need to use this new rule in order to have a tax-free distribution. It will benefit you to use this new rule only if the distribution from your Roth IRA would be deemed a nonqualified distribution.

## **Additional Tax Benefits to the IRA Accountholder**

In the case of a distribution of funds from a traditional IRA, the special pro rata taxation rule as set forth in Code section 72 for IRAs is not to be used. In the case of a nonqualified distribution from a Roth IRA, the standard ordering rules (annual contributions, conversion contributions, and then earnings) will not be used.

Rather, the distribution is treated as consisting of income first, up to the aggregate amount that would be includable in gross income (but for this provision) if the aggregate balance of all IRAs were distributed during the same year. Proper adjustments in calculating the tax treatment of future distributions are to be made to reflect the fact that "taxable income" was transferred to the charity. These distributions which were excluded from gross income are not taken into account in determining the deduction for charitable contributions under section 170.

**Example.** Sue Panko has an aggregate total of \$100,000 in her two traditional IRAs. Her basis is \$20,000. Sue has \$90,000 with IRA trustee #1, and the other \$10,000 with IRA trustee #2. Her RMD for 2006 is \$7,500. Sue decides she wishes to give \$40,000 to the Red Cross. Sue instructs IRA trustee #1 to send \$40,000 to the Red Cross on September 10, 2006. This is done by the end of September. How will this payment get treated on her 2006 federal income tax return?

The \$40,000 will be excluded from her income. The \$60,000 which remains in her traditional IRA will still have a basis of \$20,000. Presumably, the IRS will be modifying the Form 8606 so that Sue can properly reflect these transactions.

The \$40,000 distribution is not considered in determining the amount of Sue's charitable tax deduction for the year.

## **What charities qualify in order for the IRA distribution to be tax free for the accountholder?**

The so-called 50-percent organizations, as defined in Code section 170(b)(1)(A) will qualify. However, the supporting organizations described in Code section 509(a)(3) are excluded, as are donor advised funds. The qualifying 50-percent organizations are: churches, a convention or association of churches, educational institutions, hospitals, organizations supporting government schools, medical research organizations, governmental units, publicly supported organizations, common fund foundations, certain private operating foundations, and conduit foundations. Publication 526, Charitable Contributions, lists the following organizations as being the most common:

1. Churches, synagogues, temples, mosques, and other religious organizations;
2. Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt);
3. Nonprofit schools and hospitals;
4. Public parks and recreation facilities;
5. Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Clubs of America, etc.
6. War Veteran's groups.

A distribution given to a private foundation does not qualify as a tax-free charitable contribution, since a private foundation is not a public charity. Also, a distribution used to fund a charitable remainder trust or gift annuity does not qualify as a tax-free charitable contribution.

## **How do I indicate that I wish to make a qualifying tax-free charitable contribution?**

If you are an individual who qualifies for this special tax benefit, you will want to contact your IRA custodian or trustee. Your IRA custodian will have the proper form to complete to indicate the amount of the distribution and the charity to which you want the funds sent. The IRA custodian/trustee remitting the funds will also want to have the charity sign a special certification form prior to remitting the funds. The funds will then be withdrawn from your IRA and will be paid directly to the qualifying charity of your choice. This distribution will be tax free.

**Reminder:** This distribution, in general, will also be able to be used to satisfy your RMD for 2006 and/or 2007.

## **Can the charitable distribution be made from a SEP-IRA or SIMPLE-IRA?**

Distributions from SEP-IRAs or SIMPLE-IRAs are ineligible for this special treatment, as are distributions from qualified plans and other types of retirement plans.

However, unless the IRS would decide otherwise, it would be possible to roll over funds from a SEP-IRA, SIMPLE-IRA (after the two-year holding period has been met), and other types of retirement plans to a traditional IRA and then make the charitable contribution from the traditional IRA.

## **Is special IRS reporting required?**

Your IRA custodian will prepare a Form 1099-R, as they would for any IRA distribution. You will be responsible to show on your Form 1040, why the distribution is not taxable.

The 2006 IRS instructions for reporting a qualified charitable distribution on Form 1040 state:

*“If the distribution is a qualified charitable distribution (QCD), enter the total distribution on line 15a. If the total amount distributed is a QCD, enter -0- on line 15b. If only part of the distribution is a QCD, enter the part that is not a QCD on line 15b (unless another exception applies to that part of the distribution). Enter QCD next to line 15b.”*

## **Should I discuss this subject with my legal or tax advisor to make sure I qualify for this special tax treatment?**

Yes. You are entitled to exclude the transferred amount from your taxable income only if numerous conditions are met.

*The information provided in this brochure is not intended to be legal or tax advice. You should consult your attorney or tax advisor for information that relates to your specific circumstances.*

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