

Good News from Washington:

Charitable Treasure Buried in
Massive Pension Legislation



Gettysburg
COLLEGE

The Tax-Free IRA Rollover Is Finally Here —Here at Last

After a decade of near misses, the nation's charitably minded individuals finally scored a huge win when Congress passed and the president signed the Pension Protection Act of 2006 into law. While the act implements important pension-reform measures, it also creates a new and exciting gift-planning opportunity that could unleash billions of dollars in new charitable gifts from IRAs without having the amount of the gift included in a donor's gross income. *To qualify:*

- The donor must be 70½ years of age or older;
- The transfers must go directly from IRAs to qualified charities;
- Gifts cannot exceed \$100,000 per taxpayer per year; and
- Gifts must be outright.*

**Transfers to donor advised funds, supporting organizations, and charitable remainder trusts and for charitable gift annuities do not qualify.*

This opportunity is available for only 2006 and 2007, and no charitable income-tax deduction is allowed.

The way it was

Until now, IRA withdrawals were treated as taxable income and a corresponding charitable deduction was allowed subject to the percentage limitation on deductibility—50% of adjusted gross income (AGI). Ostensibly, the net result had zero tax implication—a “wash” for all practical purposes.

For a number of reasons, however, not everyone was able to take full advantage of the allowable charitable deduction for an IRA gift. The new law removes many of these impediments and creates a significant opportunity until the end of 2007 for such donors to utilize their IRAs creatively to accomplish special philanthropic objectives.

So, who benefits from the Pension Protection Act of 2006?

- **Individuals who take mandatory minimum withdrawals** but don't need additional income can satisfy up to \$100,000 of the withdrawal requirement with a direct transfer to charity.

Example: *In 2006, Jon H's required minimum distribution from his IRA is \$200,000, on which he would incur \$70,000 in federal income tax in his 35% bracket. Jon has a comfortable standard of living because of investment income. He does not really need and wishes he did not have to take the taxable distribution from his IRA. After learning about this new legislation, Jon instructs his IRA administrator to transfer \$100,000 (half) of his mandatory withdrawal to Gettysburg College.*

Result: *Jon avoids \$35,000 of income tax as a result of his generous gift.*

What if Jon decides to give the other \$100,000 to charity as well? He of course would treat that remaining mandatory withdrawal as taxable income and would be allowed a charitable deduction subject to the 50% ceiling on deductibility of charitable contributions.

- **Individuals who already give up to 50% of their AGI**—the ceiling on the allowable charitable deduction for any year—can now

transfer up to \$100,000 more from their IRA accounts, which is not subject to this limitation or taxed as a distribution. This could enable taxpayers to avoid up to \$35,000 ($\$100,000 \times 35\%$) in federal income tax on IRA distributions for this and next year.

Example: Russ H has an AGI of \$400,000, and he usually gives \$200,000 to charity. This year he turned 70½ and must take his first required minimum distribution of \$100,000, which he also contributes to Gettysburg College.

Before PPA 2006	
AGI	
(\$400,000 + \$100,000)	\$500,000
Maximum allowable charitable deduction (50%)	(\$250,000)
Taxable income	\$250,000
Unused charitable deduction (\$300,000 - \$250,000)	\$50,000*
*There is no assurance the excess deduction will be used in future years if Russ continues to give the maximum allowable amount each year.	
After PPA 2006	
AGI	\$400,000
Maximum allowable charitable deduction	(\$200,000)
Taxable income	\$200,000
The \$100,000 transfers directly from IRA to charity, bypassing AGI.	

● **Individuals who are subject to the pesky 2% rule**, which requires that itemized deductions be reduced by 2% of AGI in excess of \$150,500 for this year. Before PPA 2006, a \$100,000 withdrawal followed by a gift could result in the loss of \$2,000 (2% of \$100,000) in deductions and up to \$700 in tax savings ($\$2,000 \times 35\%$).

● **Individuals who do not itemize** and who make a charitable gift in an amount less than the standard deduction ($\$12,300$ for married couples, $\$6,400$ for single filers) will benefit from a transfer directly from their IRA to charity.

● **Individuals whose major assets reside in their IRAs** will find it convenient for this year and the next to make direct transfers to charity from their IRAs without the hassle of having to report the transfer on their tax returns.

● **Individuals who live in states where a charitable deduction is not available** for state tax purposes (check with your advisor). The new law can result in savings of up to \$7,000 in some cases because the direct transfer of \$100,000 from your IRA to charity will not show up in AGI.

Example: Joe B lives in a state that has a gross income tax; thus he would not benefit from a separate charitable deduction for his gift.

Old Result: Joe has a net tax increase equal to the amount of the state income tax.

New Result: The \$100,000 IRA is transferred directly to charity and bypasses Joe's gross income. Not only does Joe avoid \$35,000 in federal income tax, he avoids \$7,000 in state tax as well.

	\$100,000 IRA withdrawal and gift to charity	
	Before	Now
Federal income tax (35%)	\$ 35,000	-0-
State income tax (7%)	\$ 7,000	-0-
Federal tax deduction	\$ 100,000	-0-
Federal tax savings	\$ 35,000	\$35,000
State income-tax savings	-0-	\$ 7,000
Net additional tax cost	\$ 7,000	-0-

Special favorable rule

Does your IRA include any nondeductible contributions?

Helen A earns a high income and is not able to deduct all of her IRA contributions. Her IRA has a current balance of \$100,000 that consists of \$80,000 of deductible contributions and earnings (*taxable when withdrawn*) and \$20,000 of nondeductible contributions (*withdrawn tax-free*).

If Helen withdraws \$80,000 from her IRA for her personal use, then \$16,000 ($\$80,000 \div \$100,000 \times \$20,000$) of the distribution would be tax-free and \$64,000 ($\$80,000 - \$16,000$) would be taxable. Helen's new account balance will consist of \$16,000 of deductible contributions and \$4,000 of nondeductible contributions.

Helen decides to transfer \$80,000 from her IRA directly to Gettysburg College. Under PPA 2006, the entire amount will be treated as a tax-free rollover.

Equally good news is that the remaining \$20,000 in Helen's account will be treated as a nondeductible contribution and will not be taxed upon distribution.

Conclusion

The Pension Protection Act of 2006 provides a wealth of exciting new planning opportunities to many of those interested in supporting the valuable work Gettysburg College provides. We ask you to join us in this effort. Please call our office.



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175

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