

Coalition of Community Funders

**The IRA Charitable Rollover:
The Realities**

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PART I. IRA BASICS

General Concept

Congress wanted to encourage savings for retirement, so you get a tax deduction upon contributions and income taxes are deferred until the money is distributed.

A. ACCUMULATION/ WORKING STAGE

I. Contributions to IRAs

A. Basic Contribution Limits.

The Maximum Contribution for Traditional and Roth IRAs is equal to the lesser of: 1) an individual's compensation for that year that is included in gross income; or 2) the following amount:

Year	Amount
2006	\$4,000
2007	\$4,000
2008	\$5,000
2009	\$5,000*

IRC §§ 219(b)(1)(A)-(B); 219(b)(5)(A).

*Subject to an annual inflation adjustment. IRC §§ 219(b)(5)(C).

B. Additional Catch-up Contributions.

In addition to the basic contribution, individuals who will be at least 50 by the end of the year may contribution an additional contribution amount based on the following chart:

Year	Amount
2006	\$1,000
2007	\$1,000
2008	\$1,000
2009	\$1,000

IRC § 219(b)(5)(B).

II. Excess Contributions

Annual contributions in excess of the allowable amounts (e.g., \$4,000 or \$5,000) are subject to a cumulative six percent tax. IRC § 4973.

III. **Nondeductible Contributions**

- A. Nondeductible contributions may not exceed the excess of:
1. the maximum allowable contribution for the year (base and catch-up); over
 2. the amount actually allowed as a deduction. IRC § 408(o)(2)(B)(ii).
- B. There are adjusted gross income (“AGI”) (or modified adjusted gross income) (“MAGI”) ranges whereby an individual who is an active participant in a retirement plan maintained by his or her employer, will begin to lose (phase-out) the ability to deduct contributions.

Filing Status	AGI/MAGI	Begins	Ends
Single	AGI	\$52,000	\$62,000
Head of Household	AGI	\$52,000	\$62,000
Married Filing Separately	MAGI	\$0	\$10,000
Married Filing Joint	MAGI	\$83,000	\$103,000

IRC §§ 219(g)(8); 219(g)(3)(B)(iii); 219(g)(3)(A) (Amounts are for 2007 tax year).

- C. *Example. John Smith (age 50; filing status: Single; AGI \$70,000) is allowed to make a contribution of \$5,000 for the year 2007 (\$4,000 base and \$1,000 catch-up). However, John is an active participant in a retirement plan maintained by his employer, so he will be phased out of making deductible contributions. He may contribute the same amount as a nondeductible contribution to his IRA.*

IV. **Roth IRAs**

Many of the same rules applicable to traditional IRAs are applicable to Roth IRAs. However, the important differences are: 1) contributions to a Roth IRA are never deductible (IRC § 408A(c)(1)); and 2) the build-up of the IRA may be tax free upon withdrawal (see IRC § 408A). A detailed discussion of the Roth IRA is beyond the scope of this outline.

V. **Early Distributions**

A. **Penalty.**

A distribution from an IRA by an individual who is under age 59 ½ is subject to a 10% penalty unless an exception applies. IRC § 72(t)(1).

B. **Exceptions.**

Some of the exceptions to the 10% penalty include:

1. Medical insurance premiums of unemployed individuals. IRC § 72(t)(2)(D).
2. Education expenses. IRC § 72(t)(2)(E).
3. First-time homebuyer expenses. IRC § 72(t)(2)(F).

B. RETIREMENT/ MANDATORY DISTRIBUTIONS STAGE

I. **Required Beginning Date (“RBD”).**

A. **Concept.**

The RBD is the date before which an IRA owner must start distributing a portion of his or her IRA.

B. **RBD.**

The Required Beginning Date is April 1 of the calendar year following the *later* of:

1. the year in which the employee attains age 70 ½; or
2. the year in which the employee retires. IRC § 401(a)(9)(C)(i)(I)-(II).

In other words, the employee who continues to work past 70 ½ may delay the start of mandatory distributions unless the following exception applies.

C. **Exception for 5% Owners.**

If an employee continues to work after 70 ½, the RBD will typically be delayed until April 1 after the year of retirement. However, if the employee is at least a 5% owner of the business, the RBD will fall back to

70.5 (as determined in the year the employee turns 70 ½). IRC § 401(a)(9)(C)(ii)(I). Therefore, 5% owners need to start pulling money out by April 1 after 70 ½ rather than April 1 after retirement.

D. Subsequent Years.

If an owner turns 70.5 in 2006, the following April 1, 2007 is the RBD for the 2006 year. For all subsequent years, the RMD must be made by December 31st (e.g., 12/31/07 for 2007 year).

II. **Required Minimum Distributions (“RMDs”)**

A. Concept.

The amount an IRA must start withdrawing from his or her IRA as of the Required Beginning Date is equal to the Required Minimum Distribution.

B. Calculation.

To calculate the Required Minimum Distribution, you divide the Prior Year-End Balance by the Life Expectancy Factor.

$$\frac{\text{Prior Year-End Balance}}{\text{Life Expectancy Factor}}$$

The Life Expectancy Factor is derived from the Uniform Lifetime Table unless the surviving spouse is the sole beneficiary and is more than 10 years younger than the owner-spouse. In that case, the Joint and Last Survivor Table is used. See Appendix A.

C. Penalty for Failure to take RMDs.

The penalty for failing to take out RMDs is 50% of the excess between the RMDs and the actual distribution. IRC § 4974(a).

Example: H pulled out \$3,000 when he should have taken \$10,000. The penalty will be 50% of \$7,000 (or \$3,500).

E. Calculation for Multiple IRAs.

If the IRA owner has more than one IRA, she may calculate the RMDs for each account separately. However, the total distribution may be taken from one or more of the IRAs. Treas. Reg. § 1.408-8, Q&A-9.

III. Taxation of Distributions

Distributions from an IRA are included in the beneficiary's gross income and are taxed at ordinary income rates. IRC § 408(d)(1). If nondeductible contributions to the IRA had not been withdrawn, a portion of the distributions will be a nontaxable return of the nondeductible contributions.

C. DEATH/ BENEFICIARY DESIGNATION STAGE

I. Beneficiary Finalization Date (Determination Date)

The estate of the IRA owner must determine the final beneficiaries of the IRA by September 30 of the year following the year of death.

II. Spouses

A. Owner dies *before* the RBD.

1. Rollover.

The surviving spouse can roll the deceased owner's IRA into his or her IRA. The benefits of a rollover include:

- a. The surviving spouse can name new beneficiaries.
- b. The surviving spouse can delay RMDs until she is 70.5.

Example: Assuming H and W have IRAs, but H dies first. W can roll H's IRA into W's IRA.

2. Sole Beneficiary: Surviving Spouse

a. More than 10 Year Younger Spouse.

The Joint and Last Survivor table is available for MRDs if the surviving spouse is more than 10 years younger than the deceased owner. See Appendix A.

b. Recalculation/ Payout (Younger Surviving Spouse).

The surviving spouse can take distributions out of the deceased owner's IRA over the surviving spouse's life expectancy as recalculated on an annual basis.

Example: Assume H is 75 and W is 67. Instead of rolling H's IRA into W's IRA, W leaves H's IRA intact. Then, she takes distributions over her longer life expectancy recalculated on an annual basis.

c. Retitle/ Make it Her Own IRA.

The surviving spouse can retitle the deceased owner's account in her name and social security number.

d. Delay (Older Surviving Spouse).

The surviving spouse can delay distributions from the deceased owner's IRA until the year the deceased owner would have been 70 ½.

Example: Assume H is 67 and W is 75. W leaves H's IRA intact, but delays distribution until the year H would have been 70.5.

3. Note that if the surviving spouse is not the sole primary beneficiary, the rules applicable to multiple beneficiaries apply (see Section III).

4. 5 years (The Five Year Rule).

The surviving spouse may take distributions within 5 years of the date of the IRA owner's death. IRC § 401(a)(9)(B)(ii).

B. Owner dies *after* the RBD (and RMDs have started).

1. Rollover.

Same as above.

2. Payout (Younger Surviving Spouse).

Same as above (younger surviving spouse's life expectancy), but the 5 Year Rule is *not available*.

3. Delay (Older Surviving Spouse).

Not available because the deceased owner has already reached 70.5.

III. Non-Spouse Individuals

A. Owner dies *before* the RBD.

1. One Individual.

The non-spouse individual beneficiary must take out the IRA distributions over that individual's single life expectancy factor (see Appendix B).

2. More than One Individual.

If the owner designated more than one beneficiary, the oldest beneficiary's life expectancy is used unless separate IRA accounts are established prior to December 31st of the year following the year of the owner's death.

3. 5 Years.

The 5-year rule can be elected for distributions.

B. Owner dies *after* the RBD (and RMDs have started).

1. One Individual.

(Same as above). The non-spouse individual beneficiary must take out the IRA distributions over that individual's single life expectancy factor.

2. More than One Individual.

(Same as above). If the owner designated more than one beneficiary, the oldest beneficiary's life expectancy is used unless separate IRA accounts are established prior to December 31st of the year following the year of the owner's death.

3. 5 Years.

The 5-year rule is *not available*.

IV. Estates and Charities

If an Estate or a Charity is named as a beneficiary, it will be treated as if the owner died without a "designated beneficiary."

A. Owner dies *before* the RBD

The balance must be distributed *within 5 years* after the owner's death.

B. Owner dies *after* the RBD (and RMDs have started)

The balance must be distributed *over the owner's (not beneficiary's) single life expectancy*.

V. **Trusts**

A. Not Qualified as a Look Through Trust.

If a trust does not qualify as a Look Through Trust, it will be treated as if the owner died without a "designated beneficiary" (i.e., same results as Estates or Charities) *unless* the trust qualifies as a "look through" trust in the next section.

B. Qualified as a Look Through Trust.

If the following qualifications are met, the beneficiaries of the trust will be treated as the deceased individual's designated beneficiaries:

1. Validity of the Trust;
2. Identification of the Trust's Beneficiaries; and,
3. Delivery of Proper Documentation to the Plan Administrator.

Treas. Reg. § 1.401(a)(9)-4, Q&A-5 & 6.

C. Look Through Trust Treatment.

1. One Beneficiary.

The individual beneficiary will be the designated beneficiary of the IRA and will be able to take distributions over her single life expectancy.

2. More than One Beneficiary.

If there is more than one individual beneficiary, the oldest beneficiary will be the designated beneficiary of the IRA for the purposes of the calculation for all of beneficiaries.

PART II. CHARITABLE PLANNING WITH IRAS

A STRATEGY #1 (LIFETIME) TRADITIONAL CHARITABLE DISTRIBUTIONS

I. Basics

A. Distribution

Before the advent of Qualified Charitable Distributions (next section), an IRA owner who wanted to benefit a charity during his or her lifetime would first take the distribution from his or her IRA. The owner would report the distribution in gross income on his or her individual tax return.

B. Charitable Contribution

The owner would then write a check to the charity. The owner would receive include that amount as a charitable contribution on his or her Schedule A, Itemized Deductions.

C. Drawbacks

The drawback with this method is the corresponding increase in income of the owner which could result in several disadvantages. (see B.III. later)..

B. STRATEGY #2 (LIFETIME) QUALIFIED CHARITABLE DISTRIBUTIONS (“QCDs”)

I. OCD Basics

A. When?

Qualified Charitable Distributions (“QCDs”) are available for distributions for the 2007 tax year only. IRC § 408(d)(8)(F).

B. Who?

Individuals who have reached the day (not year) they turn 70.5. IRC § 408(d)(8)(B)(i). This may present a problem for individuals who turn 70.5 on December 31st.

C. How Much?

The aggregate amount which does not exceed \$100,000 during the taxable year. IRC § 408(d)(8)(A).

D. Which Plans?

Distributions from IRAs, but not 401(k) plans, can be QCDs. IRC § 408(d)(8)(B).

E. Which Charities?

QCDs must be made to 170(b)(1)(A) organizations, but not supporting organizations, donor advised funds, certain private foundations, and split-interest gifts. IRC § 408(d)(8)(B)(i).

F. How Distributed?

QCDs are transferred directly to the charity. CAUTION: If the distributions is directed to the IRA owner instead of the charity, the owner will not be eligible for QCD treatment!

G. Comparison to Other IRA Rollover Proposals.

The QCD provisions differ from other IRA Rollover Proposals in that it is limited in amount (\$100,000), limited by age (70.5), limited by types of charities and gifts, and it expires in 2007.

H. Use of QCD for RMD

A QCD counts as part of the distributions made toward fulfilling an IRA owner's Required Minimum Distribution for the year. Treas. Reg. §§ 1.401(a)(9)-5, A-9(a); 1.408-8, A-11(a).

II. **QCDs Compared to Traditional Charitable Deductions**

A. Traditional Charitable Distributions

1. Step 1: Take distributions from retirement plans.
2. Step 2: Report the distribution on Form 1040 and include it in Gross Income.
3. Step 3: Deduct the distribution as a Charitable Contribution on Schedule A, Itemized Deductions.

B. Qualified Charitable Distributions

1. Step 1: Take distributions directly to Charities.

2. Step 2: Exclude the distributions from Gross Income.
3. Step 3: Do not deduct the distribution as a Charitable Contribution on Schedule A, Itemized Deductions.

III. **QCD Advantages (Traditional Method Disadvantages)**

A. **Traditional Giving Increases Gross Income.**

The Traditional Method means the distribution will be included in gross income (with a corresponding deduction for the charitable contribution). However, the fact that the distribution is included in income means gross income will be higher than using a QCD. This may have an adverse impact on:

1. the phase-out of itemized deductions;
2. the deductibility of medical expenses;
3. the taxability of social security benefits; and,
4. the AGI limits on contributions and the amount of charitable contribution carry over to another tax year.

B. **Lower Income Brackets Might Not Itemize Deductions.**

1. If an individual does not have enough deductions to itemize his or her deductions on Schedule A (i.e., the standard deduction is larger than the total of all itemized deductions), the charitable contributions will not be beneficial to the taxpayer.
2. *Example: John earns \$10,000 in 2007 and gives \$5,000 from his IRA to a charity using the Traditional Method. If John does not have enough itemized deductions, there is no corresponding deduction to the Inclusion in Gross Income.*

IV. **QCD Planning Idea**

- A. A QCD is deemed to be from the deductible portion of the IRA first, then the nondeductible portion. IRC § 408(d)(8)(D).
- B. *Example. H is 71 and has \$70,000 (\$50,000 deductible; \$20,000 nondeductible) in his IRA. H could take a QCD of the \$50,000 portion,*

leaving only \$20,000 of nondeductible money which could (if he is eligible) be rolled into a Roth IRA.¹

C. STRATEGY #3 (LIFETIME) INDIRECT DISTRIBUTIONS FOR THE BENEFIT OF A CHARITY

I. Concept.

The IRA may take out distributions during her life to provide an indirect benefit (life insurance) or future benefit (real estate, art) that will ultimately be given to a charity.

II: Examples.

A. Life Insurance Policies.

The distribution might be used to pay the premiums on a life insurance policy on the IRA owner in favor of the charity. This is a good method for replacing the lost income of the deceased benefactor.

B. Purchase Items.

The distributions might be used to purchase items during life that will eventually be gifted to a charity after the owner dies (e.g., real estate, artwork, artifacts, etc.).

D. STRATEGY #4 (BENEFICIARY DESIGNATION) NAME A CHARITY AS 100% BENEFICIARY

I. Concept.

The IRA owner may have sufficient wealth outside of her IRA. She might decide to give the entire amount of her IRA to a charity. There are no issues with the type of payout because the charity might as well receive all of the IRA immediately as there is no income tax on the IRA when it is distributed.

II. Sample Beneficiaries.

A. Public Charity.

B. Private Foundation.

¹ Natalie Choate, Recent Developments in Retirement Planning: Hot Topics and New Ideas, 30-6, Notre Dame Estate Planning Institute (October 6, 2006).

- C. Donor Advised Fund.
- D. Charitable Remainder Trust.

E. STRATEGY #5 (BENEFICIARY DESIGNATION) NAME A CHARITY BY USING A FRACTIONAL AMOUNT

I. Concept.

The IRA would be split up in accordance with the percentages listed on the IRA provider's beneficiary designation form.

II. Sample.

*10% to the Berrien Community Foundation;
50% to my Daughter; and,
40% to my Niece.*

III. Planning Ideas.

- A. Move the IRA into Separate Accounts for the beneficiaries prior to the Beneficiary Finalization Date so that life expectancy payouts for the daughter and niece would be preserved.
- B. Cash out the charity prior to the Beneficiary Finalization Date so that life expectancy payouts for the daughter and niece would be preserved.

IV. Caution.

If the planning ideas above are not implemented, the beneficiaries run the risk of losing the life expectancy payouts. One possible solution is to set up Separate Accounts prior to death. However, the administrative burdens of the Separate Accounts should be weighed against the benefits.²

F. STRATEGY #6 (BENEFICIARY DESIGNATION) NAME A CHARITY BY USING A PECUNIARY AMOUNT

I. Concept.

The IRA would be split up in accordance with a pecuniary (i.e., dollar) amount, with the balance to other beneficiaries.

² Natalie Choate, Life and Death Planning for Retirement Benefits § 7.2.02 (Ataxplan Publications 6th ed. 2006)

II. Sample.

*\$10,000 to the Berrien Community Foundation; and,
Balance to my Daughter.*

III. Planning Ideas.

- A. If the IRA Provider permits it, move the IRA into Separate Accounts for the beneficiaries prior to the Beneficiary Finalization Date so that a life expectancy payout for the daughter would be preserved.
- B. Cash out the charity prior to the Beneficiary Finalization Date so that a life expectancy payout for the daughter would be preserved.
- C. Place a small Pecuniary Bequest in the Will.
- D. Make the gift to the charity conditional upon distribution by the Beneficiary Finalization Date with backup provisions in the Will.³

G. STRATEGY #7 (BENEFICIARY DESIGNATION) NAME A CHARITY BY USING A FORMULA AMOUNT

I. Concept.

The IRA would be split up in accordance with a formula tied to items outside of the IRA.

II. Sample.

*10% of my Gross Estate to the Berrien Community Foundation; and,
Balance to my Son.*

III. Planning Ideas.

The IRA Provider may be reluctant to accept this designation, so provide in the designation form that the executor will perform the calculation of the formula.⁴

³ Choate, Life and Death Planning for Retirement Benefits § 7.2.03.

⁴ Choate, Life and Death Planning for Retirement Benefits § 7.2.04.

Excellent Resources for Additional Research

Internal Revenue Code and Regulations

Internal Revenue Service Publication 590

Natalie Choate, Life and Death Planning for Retirement Benefits (Ataxplan Publications 6th ed. 2006).

Authors who write extensively in the IRA/Charitable Planning area include: Natalie Choate (www.ataxplan.com), Robert Keebler (www.rothira.com), Larry Katzenstein, and Christopher Hoyt.

APPENDIX A

Uniform Table

For Use By: 1) unmarried owners; 2) married owners whose spouses are not more than 10 years younger; and 3) married owners whose spouses are not the sole beneficiaries of their IRA.

Age of IRA Owner	Distribution Period		Age of IRA Owner	Distribution Period
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

The **Joint and Several Table** (for use by owners whose spouses are more than 10 years younger and are the sole beneficiaries of their IRA) is available in Publication 590. Publication 590 can be accessed on the IRS website at: <http://www.irs.gov/pub/irs-pdf/p590.pdf>

APPENDIX B

Single Life Expectancy
For Use by IRA *Beneficiaries*

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	82.4	28	55.3	56	28.7	84	8.1
1	81.6	29	54.3	57	27.9	85	7.6
2	80.6	30	53.3	58	27.0	86	7.1
3	79.7	31	52.4	59	26.1	87	6.7
4	78.7	32	51.4	60	25.2	88	6.3
5	77.7	33	50.4	61	24.4	89	5.9
6	76.7	34	49.4	62	23.5	90	5.5
7	75.8	35	48.5	63	22.7	91	5.2
8	74.8	36	47.5	64	21.8	92	4.9
9	73.8	37	46.5	65	21.0	93	4.6
10	72.8	38	45.6	66	20.2	94	4.3
11	71.8	39	44.6	67	19.4	95	4.1
12	70.8	40	43.6	68	18.6	96	3.8
13	69.9	41	42.7	69	17.8	97	3.6
14	68.9	42	41.7	70	17.0	98	3.4
15	67.9	43	40.7	71	16.3	99	3.1
16	66.9	44	39.8	72	15.5	100	2.9
17	66.0	45	38.8	73	14.8	101	2.7
18	65.0	46	37.9	74	14.1	102	2.5
19	64.0	47	37.0	75	13.4	103	2.3
20	63.0	48	36.0	76	12.7	104	2.1
21	62.1	49	35.1	77	12.1	105	1.9
22	61.1	50	34.2	78	11.4	106	1.7
23	60.1	51	33.3	79	10.8	107	1.5
24	59.1	52	32.3	80	10.2	108	1.4
25	58.2	53	31.4	81	9.7	109	1.2
26	57.2	54	30.5	82	9.1	110	1.1
27	56.2	55	29.6	83	8.6	111+	1.0

APPENDIX C

Summary of Planning Ideas for Meetings with Donors

Charitable planners may use the following guidelines when meeting with potential donors about gifts to charity. Planners should discuss with the donors the timeline for the donors' contributions to the charity. As an example, will the donors fund the charity during life; after death; or a combination of both? Will other parties (e.g., children) be part of the planning?

Distributions (during life)

1. Traditional Method

Take a Distribution (between 59.5 and 70.5) and pay all or part to a Charity; Include in Gross Income, but take an offsetting Charitable Contribution.

2. Qualified Charitable Distribution

Take a Qualified Charitable Distribution (over 70.5) in favor of a Charity.

3. Other Ideas

Use a portion of a Minimum Required Distribution to Fund Life Insurance Policy in favor of the Charity.

Beneficiary Designations (at death)

1. All to a Charity

Public Charity
Private Foundation
Donor Advised Fund
Charitable Remainder Trust

2. Fractional Gift

Example: 10% to Charity; 90% to Daughter.

3. Pecuniary Gift

Example: \$50,000 to Charity, Balance to Daughter.

4. Formula Gift

Example: 10% of my estate to Charity.