

# ESTATE PLANNING NEWS



## Charitable IRA Gifts:

### Who Wins With a Qualified Charitable Distribution?

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The Pension Protection Act of 2006 permits a person over age 70.5 to exclude from taxable income up to \$100,000 of charitable gifts made directly from an individual retirement account ("IRA"). The donor will not have to report the IRA distribution as taxable income, but the donor will not be able to claim a charitable income tax deduction for the gift.

How popular were IRA gifts in the last four months of 2006 when the law became effective? As the result of an on-line survey, the National Committee on Planned Giving reported (as of January 18, 2007) 1,468 gifts totaling \$30 million. Approximately 52% of the gifts were \$5,000 or less, and 9% of the gifts were the legal maximum of \$100,000, resulting in an average gift amount of \$20,365.

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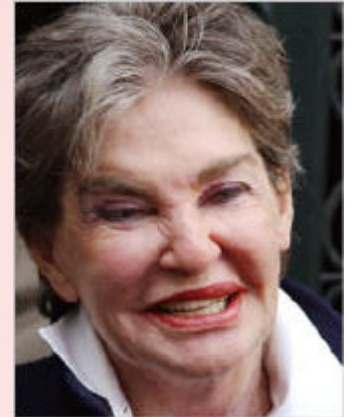


# Estate Planning News

## Announcements

Leona Helmsley, a billionaire New York City hotel operator and real estate investor, died on August 20. From her will, we know that she left most of her estate to charity, \$10 million to her son, \$5 million to each of two grandchildren, nothing to her two other grandchildren (“for reasons that are known to them”), and \$12 million to her dog, Trouble.

The specifics of Helmsley’s gift to Trouble are not publicly known because they are spelled out in private trust documents. A strongly written trust could protect Trouble’s gift from becoming the subject of a court fight, especially if unused funds are ultimately designated to charity.



## Tip of the Month

### **Creditor Cannot Force Distribution from Discretionary Trust**

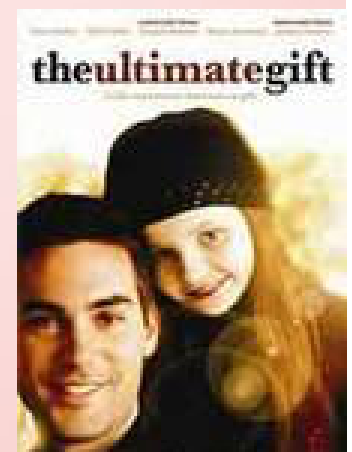
A California appellate court issued an opinion in *Young v. McCoy* which will provide encouragement and comfort to trust creators who seek to preserve assets for their beneficiaries. The court ruled that a creditor cannot force the trustee of a discretionary trust to make a distribution to the beneficiary, if the trustee has reasonably determined that the beneficiary does not need a distribution to provide for his or her health, education, maintenance or support.

The practical effect is that, since there is no distribution, the creditor cannot get its hands on funds which have been preserved for the beneficiary.

## Entertainment

### **The Ultimate Gift (2006)**

When his wealthy grandfather (James Garner) finally dies, and his will is read, Jason Stevens (Drew Fuller) fully expects to benefit. But instead of a sizeable inheritance, Jason receives a test, a series of tasks he must complete before he can get any money. Co-starring Abigail Breslin and Lee Meriwether.



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They who dream by day are cognizant of many things which escape those who dream only by night.

-- EDGAR ALLAN POE  
*Eleonora*

## Charitable IRA Gifts

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### Who Wins With a Charitable IRA Gift?

#### **1) Donors Who Don't Itemize**

The biggest winners are probably IRA owners over age 70.5 who do not itemize their income tax deductions. Since the charitable deduction is an itemized deduction, they generally have the worst tax treatment: they have to report the entire distribution as taxable income but receive no offsetting deduction. In theory, they should make all of their charitable gifts from their IRAs.

#### **2) Donors Who Lose Tax Deductions as Adjusted Gross Income (AGI) Increases**

##### **a) Phaseout of Itemized Deductions**

A common lost deduction is the phaseout of itemized deductions as income increases over \$156,400 (or \$78,200 if married filing separately). By keeping AGI low, donors get more itemized deductions.

##### **b) Phaseout of Dependent and Personal Exemption Deductions**

High-income taxpayers cannot claim personal exemptions for themselves or their dependents. By avoiding the recognition of IRA distributions, taxpayers in the affected thresholds (\$234,600 if married filing jointly, \$195,500 if head-of-

household, \$156,400 if single, and \$117,300 if married filing separately) may be able to deduct personal exemptions and dependent deductions.

##### **c) Social Security Payments**

If a Social Security recipient's modified AGI is over \$44,000 (married-joint) or \$34,000 (single or head-of-household), then 85% of the Social Security payments are taxable. However, if modified AGI is under \$32,000 or \$25,000, respectively, then Social Security payments are fully tax-exempt. By avoiding the recognition of taxable IRA distributions, a Social Security recipient may pay less tax.

##### **d) Other Phased-Out Deductions**

Other deductions that are subject to phase-outs are "miscellaneous itemized deductions," medical expenses, and non-business casualty losses.

#### **3) Donors Subject to the 50% Annual Charitable Deduction Limitation**

Charitable deductions cannot exceed 50% of a taxpayer's AGI in any year. A donor who is subject to this limitation and uses a taxable distribution from a retirement plan account to make an additional charitable gift could generally deduct only 50% of that amount in the year of the gift.

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## Charitable IRA Gifts

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But, if the charitable gift is instead made from an IRA to the charity, there will be no extra income tax.

#### **4) Wealthy Individuals Who Want to Reduce the Size of Retirement Assets**

Most inherited stock, real estate, and other assets receive a step-up in tax basis at death. But IRAs get no new basis, and inherited retirement distributions are generally taxed as income in respect of a decedent. In taxable estates, the combination of estate taxes and income taxes can produce an effective tax rate of over 80%. Therefore, some seniors draw down their retirement accounts to reduce the proportion of their wealth in these assets. The charitable IRA exclusion offers an opportunity to withdraw up to \$100,000 for charitable gifts without triggering some of the problems that large distributions might normally cause (*e.g.*, the phase-out of itemized deductions).

#### **Who Doesn't Win: Donors Who Are About to Sell an Appreciated Asset**

Charitable gifts of appreciated stock, mutual funds, and real estate have traditionally provided donors with superior income tax benefits. By contributing property before sales negotiations are finalized, the donor can usually deduct the entire fair market value of the property and also avoid the 15% federal long-term capital gains tax that the sale would have generated. Given the choice between contributing such property and making a qualified charitable distribution from an IRA, the

tax savings from avoiding the 15% tax will probably be greater than the taxes saved from using the charitable IRA exclusion.

#### **Seven Legal Requirements**

There are seven legal requirements for an IRA distribution to be recognized as a qualified charitable distribution:

- 1) Donor must be at least age 70.5.
- 2) Distribution must be made from an IRA (no other retirement plans qualify).
- 3) Distribution must be made directly from the IRA to the charity.
- 4) Donee must be a public charity or a private operating foundation, or possibly a conduit private foundation.
- 5) Distribution otherwise qualifies for a full charitable income tax deduction.
- 6) Distribution is otherwise taxable, up to \$100,000 per year.
- 7) Charity must issue a contemporary written acknowledgment describing the amount of cash contributed and certifying that the donor did not receive any financial benefits in exchange for the gift.

#### **Conclusion**

Barring an extension, the law allowing charitable IRA gifts is scheduled to expire on January 1, 2008. Charitably-inclined IRA owners over age 70.5 should consult with their tax advisors today to determine whether this tax savings opportunity makes sense.

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