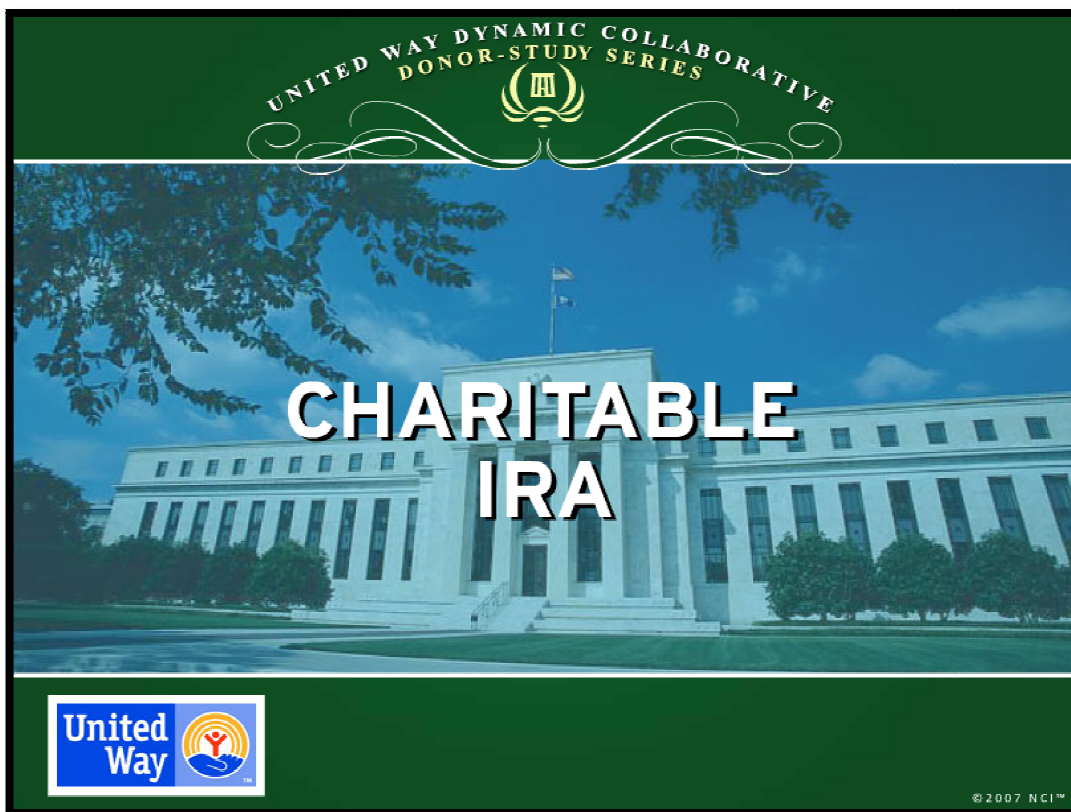


UNITED WAY DYNAMIC COLLABORATIVE™
DONOR-STUDY SERIES



CHARITABLE IRA

QUESTIONS & ANSWERS



United Way of Central New Mexico



Charitable IRA

Q & A

What is an individual retirement account?

An *individual retirement account (IRA)* is a nonqualified retirement plan. It is called nonqualified because it is not an employee benefit plan that is subject to the Employee Retirement Income Security Act (ERISA) of 1974.

Even though IRAs are not subject to the protections offered by ERISA, most retirement assets end up in an individual participant's IRA because of the flexibility of IRAs.

Earnings such as interest and dividends and capital gains on the assets inside your IRA are not taxed until you withdraw the funds. This can provide years of income tax-free compounding, which will result in increased retirement savings.

IRAs are widely available from banks, insurance companies, mutual fund management companies, brokerage houses, and other sellers of investment products that can be used to fund such an account. An IRA must be in the form of a written trust or custodial account held for the exclusive benefit of the IRA owner.

IRAs can be any of three types:

1. Those that are established by an individual with a bank, brokerage firm, or similar company that acts as a trustee of the investments;
2. IRAs in the form of annuities or endowment contracts purchased by individuals from insurance companies; and
3. IRA plans that are established by employers and employee associations.

Do the same general rules for income and estate taxation apply to IRA and qualified retirement plan proceeds?

Yes, they do. Even though ERISA applies to qualified plans and not IRAs, the same income and estate tax rules that apply to qualified plans generally apply to IRAs.

The income taxation rules for Roth IRAs, for example, are different, so it is important that you understand what kind of IRA you have.

Why is having a designated beneficiary important?

It is the life of the oldest designated beneficiary that is used to determine the period of time over which the proceeds can be paid. If you want to leave your IRA or other retirement plans to individuals, then having designated beneficiary status will allow them to defer taking out the proceeds, which will subsequently defer the income taxation on the proceeds.

You should always consult with your tax advisors to make sure that the beneficiaries that you have named for your IRA and other retirement accounts are correct given your planning wishes.

Can I give my IRA directly to a charity while I'm living?

Yes, but there may be adverse consequences by doing so. When assets are transferred during your lifetime from your IRA (or qualified retirement plan) directly to a charity, the transaction will be treated as if the distribution were first made to you, followed by a charitable donation. As a result, whatever amount is withdrawn must be included on your income tax return for that year as ordinary income. This amount will be offset by a charitable deduction equal to the amount of income withdrawn. Because of the percentage of adjusted gross income limitations and the phase out of itemized deductions, you may not be able to use all of the deduction in the year of the donation, which means that you would likely have an income tax liability.

In addition, if you make a withdrawal before you are 59½ years of age and give it to charity, a 10 percent premature distribution penalty will apply.

Several bills have been introduced in Congress, including some that are pending, that would allow tax-free distributions from IRAs after a certain age for charitable contributions. Most charitably-minded people hope Congress will allow this in the near future.

Why should I have to pay income taxes if I donate my entire IRA to charity?

Charitable deductions are always limited to no more than 50 percent of your adjusted gross income and in some cases even less. As an example, suppose your

adjusted gross income is \$50,000 this year, before any distributions from your qualified retirement account. If you donate \$100,000 from your retirement account to charity this year, your adjusted gross income instantly increases to \$150,000. However, your charitable deduction for the year is limited to \$75,000 (50 percent of your adjusted gross income). While this may be offset somewhat by the fact that you can carry forward the remaining \$25,000 deduction for up to 5 years, the immediate effect of your generosity is that you will have to pay income tax this year on \$25,000.

For taxpayers who are in high income tax brackets, there is an additional disadvantage of donating an IRA or retirement plan to charity. Charitable donations are treated as itemized deductions. Itemized deductions are phased out as income increases so that taxpayers with very high incomes can lose up to 80% of many of their itemized deductions, including charitable deductions. The phase out of itemized deductions is itself being phased out so that in 2009 it will be gone. After then, if the law does not change again, the full amount of the charitable deduction can be used by all taxpayers.

I heard that giving my IRA to charity can make sense under some circumstances. How could that possibly be?

While you may donate IRA assets to charity during your life, it may make more sense for you to name a charity as the beneficiary of your IRA. By leaving IRA assets to your favorite charity or charities at your death, your family avoids the income tax on the assets and your estate receives an estate tax deduction. This technique makes tax sense since your beneficiaries (in the absence of further planning), may, under the most severe circumstances, receive as little as 22 cents on the dollar after taxes, while the charity could receive 100 percent.

Are there any pitfalls to using my IRA to fulfill a charitable bequest?

Not really, but there are some issues that you should be aware of. If you name a charity as sole or partial beneficiary of your IRA, you would generally be considered as not having a "designated beneficiary" under the minimum distribution rules.

The general rule is that if you die before your required beginning date without a designated beneficiary, the entire account must be distributed (and therefore taxed) to all beneficiaries by December 31st of the fifth year following your death. If you die after your required beginning date without a designated

beneficiary, the account must be distributed over your remaining life expectancy. So, if you leave your entire IRA to a charity, these rules apply, but usually do not really matter since most times the IRA proceeds pass to charity immediately upon your death.

There are two exceptions to these general rules if you name charities *and* individuals as beneficiaries of your IRA or if you name a trust containing both charitable and individual beneficiaries as the beneficiary of your IRA. If all charitable beneficiaries are "cashed out" prior to September 30th of the year following your death ("the determination date"), then your remaining individual beneficiaries will qualify for designated beneficiary status. Alternatively, if separate accounts are established for each charity and individual beneficiary prior to the determination date, then the remaining individuals will qualify for designated beneficiary status.

Who may be the designated beneficiary of my IRA or qualified retirement plan?

Only an individual or a "qualified" trust can be a designated beneficiary. A trust is a "qualified" trust if it meets certain requirements:

1. The trust must be valid under state law.
2. All beneficiaries of the trust must be individuals.
3. The beneficiary of the trust must be identifiable from the trust document.
4. A copy of the trust instrument (or certain selected information about the trust) must be provided to the plan administrator (for qualified plans) or custodian (for IRAs) by October 31st of the year following the year of your death.
5. The trust must be irrevocable on death.

An estate, a nonqualified trust, or a charity cannot be a designated beneficiary.

Why do individuals who do not appear to be especially philanthropic name a charity as the beneficiary of some of their retirement plan assets?

Naming charity as the beneficiary of an IRA or a qualified plan can, in some circumstances, be an advantageous way to leave assets to family members. While

IRA and qualified plan proceeds are subject to income taxation at the time of withdrawal, withdrawals made by a qualified charity are exempt from income taxation. It is, therefore, sometimes a better strategy to leave assets to family members that are not subject to income taxation and leave IRA assets to charity so that no income tax is due.

I want to make a charitable contribution with some of my retirement plan assets, including my IRA, but I want to make certain that my spouse will have enough to live on after my death. What should I do?

If you have no intended beneficiaries besides each other, your IRAs and other tax-deferred retirement plans make excellent sources for charitable bequests. As you know, the full amount distributed from these plans is taxable as ordinary income to the beneficiaries when you die. If a charity is the beneficiary, these assets escape income taxation and also lower the size of your taxable estate.

The easiest way to implement this strategy is for you and your spouse to name each other as primary beneficiary of each other's IRA and your intended charity as the contingent beneficiary. Upon your death, your account can be rolled over tax-free to your spouse's account, who then changes the primary beneficiary to your charity. Upon the subsequent death of your spouse, the proceeds pass tax free to the charity.

What if we are both charitably inclined, but we are not certain if the surviving spouse will need to have full access to the retirement plan and IRA accounts?

You would use the same strategy as discussed above. Name each other as the primary beneficiary of each other's IRA and retirement plans, and name your charity as the contingent beneficiary. Upon the first death, the surviving spouse can either roll the accounts into his or her IRA or disclaim the proceeds in favor of the charity. The surviving spouse can name charities as the primary beneficiaries on any account not disclaimed. This wait-and-see approach allows maximum flexibility.

If I name my child and my favorite charity as equal beneficiaries of my qualified retirement plan or IRA, do I have a designated beneficiary?

No. If you name multiple primary beneficiaries, the rules require that each named beneficiary must qualify as a designated beneficiary, even though for purposes of the Internal Revenue Code only one will be deemed your designated

beneficiary. If you name more than one person as beneficiary, the oldest person is deemed to be your designated beneficiary. It is the life of the oldest designated beneficiary that is used to determine the period of time over which the proceeds can be paid.

If any portion of the benefit is to be distributed to a beneficiary who would not qualify as a designated beneficiary, then you will be treated as if you don't have any designated beneficiary for the entire plan or IRA. Since your beneficiary designation was 50 percent to your child and 50 percent to your charity, you will be deemed to have no designated beneficiary because a charity cannot qualify as a designated beneficiary.

Fortunately, the law provides two exceptions if charities and individuals are entitled to retirement proceeds. First, if the charity is fully paid prior to September 30th of the year following your death, your child will qualify for designated beneficiary status. Second, if you establish separate accounts for your charity and child prior to September 30th of the year following your death, then your child will qualify for designated beneficiary status.

The IRA and retirement plan rules seem complicated. What do I do if I am not sure what to do?

You are right in thinking that the retirement plans rules are complex. In addition, trying to educate yourself can be a time consuming and frustrating experience because it is sometimes difficult to find understandable literature that explains what to do in a particular situation.

It is imperative that you seek out competent and experienced income and wealth planning advisors who understand the laws and who can apply them to you and your family.



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