A Post-IRA Charitable Rollover Survival Guide

The sun has now set on the IRA charitable rollover for the fourth time. Naturally, we all hope it will soon rise again, ideally in a permanent fashion and with a new brilliance that shines not only on outright transfers but also on life income arrangements.

Nevertheless, by no means should we regard ourselves as having been plunged into darkness. On the contrary, we continue to have a number of options we can – and should – be encouraging donors to consider.

Some Perspective

Donors liked the rollover because it was relatively simple. Moreover, in those years when a rollover gift could be counted against a donor's required minimum distribution, a certain tax efficiency was achieved.

Charities liked the rollover because it resulted in "now money." It also provided an easy way to get donors to focus attention on the general notion of using assets in an IRA to make a charitable gift. In essence, it gave charities an appealing lead-in for discussions that could eventually touch on one or more of the options highlighted later in this article.

Still, the rollover had a number of limitations:

- Not surprisingly, the *IRA* charitable rollover applied only to IRAs, not to 401(k)s, 403(b)s, and other qualified retirement plans.

- Even among IRAs, only certain kinds – traditional and Roth, as opposed to SEP IRAs and Simple IRAs – could be drawn upon to make a rollover gift (technically known as a "qualified charitable distribution" or "QCD").

- With the exception of private grant making and conduit foundations, public charities were the only charitable organizations to which a QCD could be made. In addition, a QCD received by a public charity could not be used to establish or supplement a donor advised fund. Furthermore, it was not possible for a QCD to be made to any type of supporting organization, this despite the fact that such organizations otherwise enjoy public charity status.

- The larger principle behind the limitations described in the immediately preceding bullet point is that the donor was not supposed to receive any type of benefit in exchange for a QCD, even if that "benefit" was simply some potential influence regarding how the charity receiving the QCD might use it to make a grant to another charity. Thus, as already noted at the beginning of the article, a QCD could not be used to fund a charitable remainder trust, a pooled income fund, or a charitable gift annuity. Interestingly, however, it was acceptable for a donor to have a public charity receive a QCD in order to satisfy a pledge the donor may have made to that charity.

- Although relevant only to the very wealthiest of donors, no more than $100,000 worth of QCDs could be made by a single donor for a single year.

- The donor had to be at least age 70-1/2.

- For some donors, the major selling point of the IRA charitable rollover, i.e., the fact that a QCD would not be added to adjusted gross income (AGI), was of no net value in the end. In lieu of completing an IRA charitable rollover, they could simply receive an IRA distribution and then contribute that amount to any charity. In return, they would receive a deduction. *So long as they itemized their deductions and were able to use the full deduction in the year of the gift without bumping into any of the rules that limit the extent to which a charitable deduction can be claimed*, they were in essentially the same position as if they had made an IRA rollover gift. That being said, in the case of donors for whom an increase in AGI (even one offset by a deduction) presented its own problems, such as limiting the use of personal exemptions, for example, the rollover route would have been preferable.

Current Gift Options

One important thing to keep in mind about the IRA charitable rollover is that it was ultimately just an additional way of using an IRA to make a current gift. It did not replace or foreclose any of the choices donors have had all along.

As the last of the bullet points in the preceding section indicates, a donor can always engage in a two-step process of taking a distribution from an IRA and then writing a check to a favorite charity. The donor simply needs to be sure that the income attributable to the distribution can be completely offset by the resulting charitable deduction. Oh, and the donor also needs to be at least age 59-1/2, in order to avoid a 10% penalty tax under Section 72(q) of the Internal Revenue Code.

The beauty of this very basic approach is that it is available not only with any type of IRA, but also with a qualified retirement plan. Moreover, the donor’s gift can be of any size and can be made to any type of qualified charity.

A donor who has long-term appreciated publicly traded securities can obtain extra tax mileage by using such assets to make the charitable gift instead of writing a check. While it may be a bit tricky to get the value of the securities to match to the penny the amount distributed from the donor’s IRA or qualified plan, the donor will receive a deduction for the full value of the securities and avoid tax on any of the gain. The donor can then use the cash distributed from the IRA or qualified plan to repurchase the same securities. This time, they will have a higher basis, thereby decreasing the taxable capital gain the donor would recognize if the securities continued to increase in value and were then sold by the donor.

Ironically, a donor can even ignore the most recent expiration of the IRA charitable rollover legislation by going ahead and making a rollover gift anyway. If perhaps the rollover is revived later this year in a retroactive manner (as has been the case with previous versions of the rollover), then the amount distributed from the IRA directly to the charity should end up being a QCD. If the rollover really does end up being strictly a thing of the past, then the amount of the distribution will be added to the donor's AGI, but the donor will also receive a deduction equal to the amount distributed. So long as the donor can claim the deduction fully, the goal of a tax-free transfer has been met. The only wrinkle if the rollover comes back to life is that the charity will need to acknowledge the gift as a standard cash contribution initially, but later issue a superseding acknowledgement reflecting the fact that the gift turned out to be a QCD.

A Life Income Variation

A donor wishing to use IRA or qualified retirement plan assets to secure a stream of tax-favored life payments can do so with a gift annuity. The donor just needs to realize that a portion of what is distributed will need to be retained to pay tax on the portion of the distribution not offset by the charitable deduction received in connection with establishing the annuity.

PG Calc's *Charitable Gift Annuities: The Complete Resource Manual* offers this guidance on calculating how much to contribute and how much to retain for taxes:

$$C = \frac{W\,(1 - R)}{1 - RD}$$

where:

C = contribution for gift annuity
W = distribution from IRA or qualified retirement plan
R = donor's income tax marginal rate
D = deduction factor (i.e., percentage of contribution that is deductible)

Note: The formula becomes somewhat more complicated if different marginal rates apply to the deduction.

In lieu of establishing a gift annuity, a donor could simply take distributions from the IRA or qualified retirement plan during life starting no earlier than age 59-1/2 and designate a charity as the beneficiary of whatever remains upon death. The distributions would be fully taxable, but (subject to the required minimum distribution rules that take effect at age 70-1/2) they could vary in amount from year to year. By contrast, the amount paid in connection with a gift annuity would be the same each year.

Deferred Gift Options

Gift planners are generally aware that the most tax efficient way to make a charitable gift upon death is to use assets which, if they were instead left to family members or other individuals, would include previously untaxed income. Such "income in respect of a decedent" (IRD) is typically a feature of assets in an IRA or a qualified retirement plan. When IRD is received by a tax-exempt charity, however, no tax is paid. In addition, as with any testamentary charitable gift, there is an unlimited estate tax deduction for the amount contributed. Furthermore, assets distributed directly to charity from an IRA or a qualified retirement plan avoid the probate process.

With this in mind, donors should be reminded again and again to think of IRAs and qualified retirement plans when considering how to provide for charity once their lives have ended. Whereas the IRA charitable rollover enabled a donor to achieve merely a *tax-free* transfer of assets to charity, an outright gift to charity pursuant to a beneficiary designation results in a *tax-advantaged* transfer, assuming the donor is trying to figure out what to leave for charity on the one hand and what to leave for individuals on the other.

Of course, a donor who wants to accomplish both objectives upon death with a single transfer could either set up a testamentary gift annuity using assets in an IRA or a qualified retirement plan, or else earmark such assets to fund a charitable remainder trust. The donor's estate (if large enough) would benefit from an estate tax charitable deduction for part of the value of the assets, one or more of the donor's heirs would receive payments for life or a period of years, and what remains would benefit charity. Even though the IRD attributable to the funding assets would flow out to the heir(s) as payments are made, the tax burden would be spread over a period of many years. Note: A testamentary transfer to a pooled income fund could be a third option.

A Word about Roths and Such

As noted toward the beginning of the article, the IRA charitable rollover pertained to assets in a Roth IRA as well as in a traditional IRA. Typically, distributions from a Roth IRA (or from a Roth 401(k), for that matter) made to a donor are entirely tax-free because they derive from contributions to the Roth made by the donor with after-tax money. Therefore, such distributions do not increase a donor's AGI, and if the donor uses a distribution to make a charitable gift, there actually is a net tax advantage in the form of a deduction that can be used to offset income that *is* part of the donor's AGI. By contrast, if a QCD is made from a Roth IRA, no charitable deduction is produced.

The only reason Congress included Roth IRAs as one of the two types of IRAs from which QCDs could be made was that in the case of certain contributions to a Roth by a donor, if the contribution was made less than five years before a distribution is taken, the amount distributed can be subject to a penalty tax. That tax is avoided if a QCD is made.

Similarly, sometimes even a portion of the assets in a traditional IRA will have been contributed to the IRA on an after-tax basis. This means that when a distribution is made to the donor directly, the donor's AGI may increase by something less than the full amount of the distribution. If a donor's traditional IRA consists of post-tax money to any extent, the donor should be sure to consult with a tax advisor about how best to draw upon the account in making charitable gifts.

Finally, keep in mind that donors continue to convert traditional IRA assets into Roth IRA assets. Those who plan to do so may be interested in earning charitable deductions that can offset some or all of the additional AGI they will have as a result of any conversions they make. Using cash, securities, or other non-IRA assets to make an outright gift or to fund a lifetime planned gift of one type or another offers these supporters an opportunity to 1) earn an immediate charitable deduction that offsets all or portion of the additional AGI, 2) further a mission they believe in, and, if desired, 3) create a stream of payments for themselves and/or other individuals.

Conclusion

Even though the IRA charitable rollover's return would be a welcome development, its absence leaves donors with plenty of alternatives to pursue. In particular, it's worthwhile to examine what can be done not only with IRA assets, but also with assets in various types of qualified retirement plans. Likewise, gifts upon death can often be as appropriate as lifetime gifts – if not more so. Indeed, gift planners must not lose sight of the fact that IRAs, along with qualified retirement plans, are ultimately sources of a donor's financial security during life. This means that lifetime gifts – whether made by means of an IRA charitable rollover or not – become realistic only for donors who can afford to make them.