CLIFFORD ASSOCIATES
Investment Counselors since 1915

Planned Giving News

THIRD QUARTER 2006

PENSION PROTECTION ACT OF 2006

by Ken Dike

President Bush signed the Pension Protection Act of 2006 (PPA 2006) on August 17, 2006. Included in this act is a provision (Sec. 1201) that allows tax-free transfers of IRA funds to public charities during 2006 and 2007.

PRE-ACT TREATMENT OF IRA FUNDS DONATED TO CHARITY

Distributions from individual retirement accounts (IRAs) that were given to a charities were included in the gross income of the taxpayers. The taxpayers then had to claim an itemized deduction on their tax returns for the amount given to the charity subject to all the limitations otherwise in force for charitable contributions such as the ceiling of 50% of the donor's adjusted gross income and other limitations on the amount of total itemized deductions allowed. This created a situation where the donor often had a net increase in tax liability from the charitable contribution of their IRA funds, since the allowable charitable deduction did not entirely offset the income recognized by the IRA withdrawal.

PPA 2006 SUMMARY

Beginning with 2006 and currently ending on 12/31/2007, direct transfers up to $100,000 per taxpayer, per year by an IRA custodian to a public charity need not be recorded as income by a IRA owner/donor who is at least 70.5. Since this charitable rollover of IRA funds is not recorded as income to the IRA owner, there is no charitable deduction available to the donor. Accordingly, the charitable rollover of IRA funds can no longer result in any increased federal tax liability. Furthermore, the IRA funds transferred to charity qualify for the owner's required minimum IRA distribution.

PPA 2006 DETAILS

To qualify for this favorable tax treatment, IRA rollover donations must be made to Sec. 509(a)(1) and Sec. 170(b)(1)(A) "public" charities. Excluded from this category of permissible charities are Sec. 509(a)(3) supporting organizations and Sec. 4966(d)(2) donor advised funds.

The transfer must be from a traditional individual retirement account or Roth IRA. Distributions from employer-sponsored retirement plans such as Simple IRAs, 401(k), and 403(b) plans do not qualify.

The transfer must be an "outright" gift. Transfers to split-interest agreements such as charitable remainder trusts or purchases of gift annuities do not qualify. The transfer may be "unrestricted" to be used in support of the general charitable purposes of the charity or may be "restricted" to a specific charitable purpose such as professorships, fellowships, scholarships or earmarked for a specific disaster relief.

For state and local income tax purposes, IRA charitable rollovers may be includable in a taxpayer's taxable income and no offsetting charitable deduction may be available.

DONOR MOTIVATIONS

Many IRA owners wait until the last few months to withdraw the minimum required amount from their IRA in order to maximize the tax-deferred IRA investment income. Wealthy donors with small IRAs often view the required minimum distribution calculation and related tax return entries as a nuisance. PPA 2006 provides an easy way to make these last-minute IRA withdrawals or eliminate the small IRA entirely. Donors can instruct their IRA administrator to transfer funds from the IRA to charities as the year-end approaches. Donors will not have to report this transfer as income and then take corresponding charitable deduction on their personal tax returns. The funds are simply transferred from the IRA to a charity with no effect on the donor's personal tax return.

Some donors are already gifting the maximum 50% of their adjusted gross income that may be offset through a charitable tax deduction. These donors

continued on insert back

AN UNCHARITABLE TRUST

by Terry Price

Recently reflecting on the events of 9/11 five years ago, we were reminded how many aspects of our lives and jobs were forever altered that day. The non-profit world has not been excluded from these changes, particularly as they pertain to worldwide bureaucratic and regulatory oversight. A reminder of society's ever-vigilant regulation recently closed airports and seized headlines when a British- and Pakistan-based terrorist group was captured after plotting to attack commercial airplanes with explosive liquids and gels.

Buried in this story's deadly plot was a link to charity. It began with the transfer of about $10 million from Britain to a Pakistani charity professing to provide relief last year following Pakistan's massive earthquake. This large transfer caught the

continued on insert back

Pension continued from insert front

usually have large IRAs which they do not usually need to support their current lifestyle. Since charitable IRA rollovers are not subject to the 50% AGI ceiling on deductible charitable contributions, such donors may give more than the 50% maximum with no adverse tax consequences. In prior years, donors were required to report the IRA withdrawals as income on their tax return but would not have been allowed to offset this income by a charitable deduction due to the 50% ceiling and other gifting by donors. As mentioned, a charitable IRA rollover is not reportable as income on the donor's tax return and the donor avoids paying tax on the amount removed from the IRA and transferred to charity.

As the portion of a taxpayer's estate held in an IRA increases, so does the future tax liability associated with the tax-deferred nature of the IRA assets. An IRA, which is considered *income in respect of decedent* (IRD), is subject to both income and estate tax when terminated upon the death of the IRA owner. Gifting through a charitable IRA rollover, rather than using non-IRA assets that are not tax-deferred, will serve to shift the donor's estate away from IRD assets, thereby reducing the income tax payable by the ultimate recipient of the donor's estate.

The portion of Social Security benefits subject to taxation can increase to 50% or 85% depending on the taxpayer's total reportable income which includes IRA withdrawals. Transferring IRA funds directly to charity, with the corresponding exclusion from the taxpayer's reportable income, can reduce the portion of Social Security benefits otherwise subject to taxation.

Older donors may not have mortgage interest to include in their itemized deductions. This could result in total potential itemized deductions, including charitable gifts, that fall short of the itemized deduction floor and limit the taxpayer to the standard deduction. A taxpayer taking the standard deduction would be better off using an IRA charitable rollover since the exclusion of the IRA withdrawal from reportable income serves to reduce the donor's tax liability. If IRA funds are received by a standard deduction taxpayer who subsequently donates these funds to charity, the taxpayer will be subject to income tax on the IRA withdrawal but will not recognize a corresponding increase in their charitable tax deductions. §

Uncharitable continued from insert front

attention of British intelligence. It is acknowledged some of the money did go to earthquake victims. But much of the funds sent to the Pakistani charity were siphoned off (money laundered) for the specific purpose of financing the terrorist scheme. As it was noted in the press, this specific al-Qaeda-linked charity had taken recent action to evade detection by changing its name. In the end, the charity proved to be the main link leading to the capture of a British citizen living in Pakistan who was the mastermind of this foiled plot.

This story illustrates the seriousness of increasing efforts to both monitor and eradicate money laundering worldwide. In the past, anti-money laundering efforts had been directed at institutions dealing mostly in cash and targeted at drug trafficking, illicit arms deals, and other crimes. But 9/11 has raised regulatory focus to a new and higher level. Going forward, we suspect requirements may tighten even further for non-profit organizations.

If the trend continues, it may be prudent for non-profit organizations to review their anti-money laundering policies and procedures pertaining to planned and other gifts. For example, documentary evidence may become a standard requirement of any donor. Besides simply accepting a name, address, and date of birth, the future process might call for specific evidence such as a driver's license, passport, or other form of ID. Similar documentation may eventually be mandatory for future beneficiaries, if different than the original donor. This was fortunately the weak link which alerted officials to the British/Pakistani plot mentioned earlier.

Something for charities to also consider might be documenting the source of specific donations. For example, was the source of a donor's specific wealth inherited, which might be documented with a trust or will? Or was the gift earned in the normal course of business? If not, what was the source? For assets owned over long periods of time, evidence of ownership through old custodial statements might provide reasonably prudent and sufficient documentation.

U.S. financial institutions must already regularly cross-reference their clients' names with the List of Specially Designated Nationals and Blocked Persons maintained by the U.S. government. They are also required to check on persons or financial facilitators domiciled within non-cooperative countries and territories as defined by the Financial Action Task Force on Money Laundering. Annual anti-money laundering training for personnel is mandatory. Similar procedures might be required of non-profits in the future.

Although admittedly burdensome, time consuming, and costly, the climate may quickly change when charities are required to initiate anti-money laundering procedures similar to those of the greater financial community. As stewards over planned giving programs, some of these issues might be prudently addressed now rather than later. Expending a small effort now collecting and verifying data as gifts are recorded may pay big dividends in the future, especially from the standpoint of donor relations, if regulators demand a review of historical donations.

We acknowledge Tom Cullinan of Tom Cullinan Charitable Giving Counsel, Inc. whose recent newsletter Donatio *provided us with facts behind the recent British terrorist plot.* §

Pasadena 200 S. Los Robles Avenue, Suite 320, Pasadena, California 91101 P 626-792-2228 F 626-792-2670
Huntington Beach 16902 Bolsa Chica Street, Suite 204, Huntington Beach, California 92649 P 714-846-2851 F 714-840-5212
Evergreen P.O. Box 2945, Evergreen, Colorado 80437 P 720-746-1244 F 720-294-9896
www.clifford1915.com