GUEST COLUMN BY
JEANNE E. LONGSWORTH, ESQ., CPA, AND KRISTIN STECKBECK BILINSKI, ESQ.

REDUCING YOUR INCOME TAX BURDEN:

LIFETIME CHARITABLE DONATIONS FROM IRAS

Jeanne E. Longsworth

Nestled in the midst of the 59 mind-numbing pages of the 2012 American Taxpayer Relief Act is Section 208. This unassuming section, fewer than 300 words, has not received much attention in the midst of the "sequester" and "fiscal cliff" pandemonium. But Section 208 cannot be ignored by charitably minded owners of traditional IRAs – and it has a looming expiration date.

Section 208 extends the deadline for lifetime charitable gifts from IRAs, gifts that can significantly reduce the traditional IRA owner's income taxes. However, in order to understand exactly why such gifts are income tax advantageous, a basic understanding of the concept of the required minimum distribution – or "RMD" – is necessary.

Beginning at age 70½, the owner of a traditional IRA (as opposed to a Roth IRA) must begin taking an RMD from the IRA annually. The RMD is computed based on the IRA owner's life expectancy and the total value of IRA assets. This annual distribution is fully taxable as ordinary income to the IRA owner, which can be very troublesome for someone who is receiving adequate income from other sources and does not need the IRA distributions.

Enter Section 208. Under the 2006 Pension Protection Act, IRA owners were allowed to transfer up to $100,000 each year directly from their IRA to certain charities, including Indiana Tech. Such transfers were termed "qualifying charitable distributions" and were considered countable towards the RMD requirements without counting toward the IRA owner's adjusted gross income. The right to make qualifying charitable distributions was set to expire on December 31, 2012, but Section 208 extended its provisions through December 31, 2013.

It is important to note that since the distribution is not included in the owner's adjusted gross income, the IRA owner does not get an income tax deduction for a charitable gift. By not including the distribution in one's adjusted gross income, a number of benefits are triggered. The most obvious is by simply decreasing the amount of income tax and social security tax owed by lowering the amount of income that would otherwise have to be reported. But reducing the IRA owner's adjusted gross income can result in other, less obvious, tax breaks. A lower adjusted gross income means a lower threshold for deducting medical expenses (which can currently be deducted only to the extent they exceed 7.5% of adjusted gross income for people older than 65). Additionally, beginning in 2013, there is a 3.8% Medicare surtax on taxpayers whose modified adjusted gross income exceeds a certain amount ($200,000 for individuals and $250,000 for married couples). Reducing the amount of adjusted gross income can potentially avoid this surtax. And lastly, because charitable contributions can only be deducted in any given year to the extent they do not exceed 50% of that year's adjusted gross income, reducing adjusted gross income can result in a more efficient and immediate use of the charitable deduction.

Now for some fine print on the use of the qualifying charitable distribution. As stated before, the maximum qualifying charitable distribution in any one year is $100,000. The qualifying charitable distribution may only be made from a true IRA – 401(k) plans, SEP IRAs and SIMPLE IRAs need not apply. Most charitable organizations, including Indiana Tech, are valid recipients of a qualifying charitable distribution, but certain charities – donor advised funds, split-interest trusts (such as charitable remainder trusts), and certain private foundations – are not. Lastly, the gift must be made directly from the IRA administrator to the charity; if funds ever pass through the hands of the IRA owner, the money immediately becomes taxable income, even if it is later used in its entirety as a charitable gift.

Unlike the owners of traditional IRAs, owners of Roth IRAs should be less interested in the use of the qualifying charitable distribution. This is because Roth IRAs do not have RMD requirements. Additionally, distributions from a Roth IRA are not subject to the income tax (because contributions to the Roth IRA have already been taxed). Therefore, there is no income tax burden to avoid with respect to the distributions from a Roth IRA. Owners of a Roth IRA who are interested in substantial charitable giving are better advised to consider a direct gift to charity, which can then be used for a corresponding income tax deduction.

If you think that a qualifying charitable distribution may be desirable for you, please talk to a trusted estate planner, tax advisor, or your IRA administrator. This can be an excellent way to reduce your income tax burden while benefitting the charity of your choice. But don't delay – you only have a few more months to act!

Jeanne E. Longsworth, Esq., CPA, and Kristin Steckbeck Bilinski, Esq. are attorneys with Longsworth Law LLC. Longsworth is also a member of Indiana Tech's Board of Trustees.