Time is Ticking on IRA-Charity Rollovers

Help your client save on their income tax while they support their favorite worthy cause.

By Patti S. Spencer

The American Taxpayer Relief Act of 2012 (ATRA) extended the qualified charitable distribution (QCD) provisions through Dec. 31, 2013.

In general, distributions from individual retirement accounts (IRAs) must be included in gross income in the year in which distribution occurs, and income taxes must be paid on the taxable portion. A qualified charitable distribution ("QCD" or charitable rollover) is not included in income.

A QCD is an otherwise taxable distribution from an IRA (other than an ongoing simplified employee pension plan or SIMPLE IRA) owned by an individual who is age 70½ or over and paid directly from the IRA to a qualified charity. An IRA owner can exclude from gross income up to $100,000 of a QCD made for 2013, and a QCD can be used to satisfy any IRA-required minimum distributions (RMDs) for the year. A married couple could potentially make a $200,000 contribution, since there is a per-person limit. The amount of a QCD excluded from gross income is not taken into account in determining any deduction for charitable contributions. This means that if your client is running up the percentage limitation for charitable gifts, using a QCD will allow your client to transfer more to charity.

ATRA reinstated the ability of a 70½-year-old individual to make a tax-free IRA distribution or rollover of up to $100,000 to a charity in 2013. The tax law applicable in 2012 did not permit this. The last time this opportunity was available was in 2011. There was a unique opportunity, available only in the month of January 2013, for an individual to roll over an additional $100,000 and have it treated as though it were rolled over in 2012.

The organization receiving the charitable distribution cannot be a non-operating private foundation, a supporting organization or a donor-advised fund, and the individual cannot receive any consideration for the distribution. Distributions from employer-sponsored retirement plans such as SIMPLE IRAs and Simplified Employee Pensions do not qualify.

Interplay with Social Security Income

Social Security (SS) income is not taxable until a taxpayer's adjusted gross income (without SS income), plus 50 percent of their SS income, plus tax-exempt interest income, plus certain other infrequently encountered additions, exceeds a specific threshold. That threshold is $32,000 for married taxpayers filing jointly, zero for married taxpayers filing separately and $25,000 for all others. Once the threshold is exceeded, the percentage of SS income subject to tax varies from 50 percent to 85 percent.

If a taxpayer is 70½ years of age or over, he or she is required to start taking required minimum distributions (RMDs) from IRAs and most other retirement plans. The amount of the RMD can impact the taxation of the taxpayer's SS benefits. For 2013, a taxpayer aged 70½ or over can make a direct IRA-to-charity distribution that also counts toward the taxpayer's RMD for the year. The distribution is not included in income (and therefore does not impact the taxability of the SS income). Obviously, the charitable contribution is not deductible, since the distribution from which the contribution was made was never includable in income for the year.

An added benefit occurs when a taxpayer has a substantial charitable contribution and he or she only marginally itemizes. Donations to charities are tax deductible only when a taxpayer itemizes deductions. By replacing the RMD income and charitable contribution with a direct IRA-to-charity rollover, the taxpayer can contribute to a favorite charity and, at the same time, exclude the distribution from income and use the standard deduction to reduce his or her taxes.

Avoiding the 3.8% Obamacare Surtax

Using the charitable rollover provision would result in a reduction in adjusted gross income. Since the new 3.8 percent Obamacare surtax applies to the lesser of 1) the taxpayer's net investment income (NII) and 2) the taxpayer's modified adjusted gross income (MAGI) reduced to a fixed threshold, reducing adjusted gross income is an important planning strategy. The threshold is $250,000 for married couples filing jointly, $125,000 for married couples filing separately and $200,000 for everyone else.

Avoiding Limits on Itemized Deductions

Effective Jan. 1, 2013, ATRA reinstated the "Pease limitation" (named after the late Congressman Donald Pease, D-Ohio) which had been eliminated for the 2011 and 2012 tax years. That limitation caps the amount of certain itemized deductions, including the charitable deduction, that an individual may take if his or her MAGI exceeds a certain threshold amount called the "applicable amount." The new law has set the applicable amounts as $250,000 for a single individual, $300,000 for a married couple filing a joint return and $275,000 for head of household. If a taxpayer's adjusted gross income exceeds the applicable amount, the taxpayer's itemized deductions will be reduced by the lesser of 1) 3 percent of the amount by which a taxpayer's adjusted gross income exceeds the applicable amount, or 2) 80 percent of all itemized deductions that are subject to the Pease limitation for the tax year.

For a high-income donor who makes a large gift to charity, the Pease limitation may significantly reduce the amount of itemized deductions that a donor might otherwise be able to take. Using the charitable rollover can avoid these limitations.

The IRA-to-charity rollover can be a true win-win. The taxpayer can reduce his or her income tax, and the charity receives a much-needed contribution.

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