

Benefits on Tap for Charitable Rollovers

The 2010 Tax Relief Act extends the tax break for so-called "charitable rollovers," but only through 2011. If a retiree is inclined to take advantage of this unique tax opportunity, he or she should move promptly.

Background: Normally, an individual can deduct the full amount of cash donations to charity, within generous limits. However, distributions from an IRA are taxed at ordinary income rates, currently reaching as high as 35%. If a taxpayer withdraws cash from an IRA and gives it to charity, it is a "wash" as far as taxes are concerned.

This is where the new tax law provision may help. As it existed under prior law, if an individual age 70½ or older withdraws funds from an IRA and donates it to charity, there is no tax on the distribution. The annual limit for such withdrawals is \$100,000. On the downside, the individual is not entitled to a charitable deduction, either.

So what has the individual accomplished with the charitable rollover? At first glance, it still appears to be a wash, but look further at these potential benefits.

*Deductions for charitable donations may be reduced by limits based on adjusted gross income (AGI). For instance, a donor's charitable deduction for 2011 cannot exceed 50% of AGI. A charitable rollover is exempt from these limits.

*Because the charitable distribution is never realized as taxable income, the individual's AGI is reduced for other tax purposes. For instance, this may increase deductions for medical expenses, miscellaneous expenses or casualty losses, just to name a few possibilities.

*If the individual is carrying over a charitable deduction from the previous year (due to an annual limit), he or she can receive the full benefit of the deduction this year. Otherwise, the regular charitable limits are applied before the carryover is allowed.

*An IRA withdrawal will often result in taxable income that could increase the tax on Social Security retirement benefits. But there is no concern with the charitable rollover.

*The distribution counts as a "required minimum distribution" (RMD). In other words, if a retiree donates the RMD directly to charity, it satisfies the obligation for the year. The remaining IRA assets can remain intact.

Note that a qualified individual can use the rollover technique with a Roth IRA as well as a traditional IRA. However, this may not be as advantageous. Reason: A Roth distribution may be tax-free anyway. In the usual situation, it makes more sense to use a traditional IRA for this technique.

Finally, contributions must qualify as legitimate charitable donations. For example, if the deductible amount is reduced because the gift is not substantiated under the tax rules, the exclusion does not apply. Contributions should be made directly by the trustee of the IRA to the designated charitable organization. Observe all the technicalities for this tax break.