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ADVISOR REPORT

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Message From The Firm

Just over three months ago, the Pension Protection Act was signed into law. Given the Act's title, we initially believed it pertained only to pension matters. However, upon a review, we determined that 15% or so of the law pertains to estate planning and exempt organization issues. Therefore, our department studied the law in great detail. As a byproduct of our effort, we are pleased to provide you with the first of four newsletters addressing important estate planning and exempt organization matters covered by the new law. Our intention is to publish an additional newsletter on this subject each of the next three weeks, so that you can be apprised of these important matters before year end. We believe timely communication of these issues is critical, since much of the law is already in effect. As our articles will explain, Congress—as usual and at the behest of the IRS—has tried to close perceived loopholes. And, as usual, Congress has made the law more complex! If you have any questions about the issues addressed in our articles, please contact the relevant author or me.

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Rollovers of Inherited Retirement Benefits by Non Spouses

By Kalyani Chirra, Esq. (KalyaniChirra@Reish.com)

Beginning January 1, 2007, non-spouses will have the option to "roll over" assets inherited from an employer-sponsored qualified retirement plan (such as 401(k), defined benefit, and pension plans) to an "inherited IRA." Prior to this change, non-spouse beneficiaries such as domestic partners and children may have been required to receive a lump-sum distribution from a qualified retirement plan, resulting in what could be significant immediate income tax liability.

The change enacted under the Pension Protection Act of 2006 allows non-spouse beneficiaries to defer the income tax by rolling over the inherited qualified retirement plan benefits to a newly formed separate "inherited IRA" established specifically to receive the distribution. The inherited IRA is in the name of the deceased participant, but payable to the beneficiary. If a participant dies before required distributions are to begin, a designated beneficiary has the option to take distributions from the inherited IRA within five years or over the life expectancy of the beneficiary, with the start date beginning no later than December 31 of the year after the year of the participant's death. If there was no designated beneficiary, distributions must be taken within five years. If a participant dies after required distributions have begun, distributions from the inherited IRA must be taken out over the life expectancy of the beneficiary, or if the deceased participant was younger than the beneficiary, over the life expectancy of the deceased participant.

The new rules apply to distributions made after 2006. If a participant died in 2006, a beneficiary may be able to take advantage of the new rules if the plan is willing to delay distributions until 2007. In the meanwhile, a beneficiary should not take any distributions from the qualified retirement plan. Once a distribution is taken the roll over option is not available.

A designated beneficiary under the new rules may be a trust maintained for the benefit of one or more designated beneficiaries. The IRS is to provide rules explaining requirements for a trust to be qualified as a designated beneficiary.

While the new law provides non-spouses with greater flexibility in planning for inherited retirement benefits, the options for non-spouses are still more limited than the options for spouses. For example, distributions from the non-spouse beneficiary's inherited IRA must be made in accordance with the required minimum distribution rules applicable to beneficiaries of inherited IRAs, which require that distributions begin regardless of the age of the beneficiary. A spouse may roll over assets into an IRA naming the spouse as owner, delaying distributions until the spouse reaches the age of 70 ½, and the new IRA may be further rolled over upon the spouse's death. ❖

IRA Rollovers for Charity

By Anna Fridman, Esq. (AnnaFridman@Reish.com)

Prior to the Pension Protection Act of 2006 (the "Act"), the usual rules relating to the tax treatment of withdrawals from IRAs were applied to withdrawals from traditional IRAs or Roth IRAs that were donated to charities. Under the new law, for the years of 2006 and 2007, an individual age 70 ½ or older can make direct charitable gifts of up to $100,000 per year from an IRA to a qualified charity and not have to report the IRA distributions as taxable income on his or her federal income tax return. Moreover, such distributions count toward the required minimum distribution.

There are several notable restrictions and specifications that apply to this new rule. First of all, the rule applies only to traditional and Roth IRAs. It does not apply to distributions from employer-sponsored retirement plans, profit sharing and other plans, including 401(k) plans, 403(b) plans, Keoghs, SIMPLE IRAs, and simplified employee pensions (SEPs). Therefore, a plan owner who has a non-qualified pension plan will need to roll over the non-qualified pension plan into a qualified IRA prior to making a distribution to charity in order to take advantage of the new law.

Furthermore, the distribution has to be made to a qualified charity and be distributed directly to the organization. Only public charities described in Internal Revenue Code 170(b)(1)(A), other than supporting organizations, qualify for such treatment. Distributions to donor advised funds of community foundations and private foundations will not receive the benefits of this new law.

The distribution from an IRA to a qualified charity will not be considered taxable income only if the entire distribution would be excluded. If the donor receives even the smallest benefit in connection with the transfer, the entire distribution will be included in taxable income. Therefore, if you distributed $200,000 from an IRA to a qualified charity, and received a $30 benefit in association with the distribution, the entire $200,000 would not qualify for the exclusion. The distribution from an IRA to a qualified charity has to be substantiated by a written acknowledgement that the charity received the IRA distribution and that the donor received no goods or services in connection with the transfer.

One of the other benefits of the new rule applies to individuals who made deductible and non-deductible contributions to their IRAs. Some plan owners make non-deductible contributions to their IRAs that, if withdrawn, would be considered a tax-free return of nondeductible contributions. Such distributions are not deemed to be qualified charitable distributions. However, the Act provides special new rules that are very favorable to taxpayers. Simply stated, taxable distributions are considered to be distributed first. This is different from the previous treatment of such distributions when the charitable distribution was viewed to be made prorata from both deductible and non-deductible contributions.

The new rule will be very helpful to those taxpayers who take the standard deduction and therefore do not get the benefit of deducting charitable contributions. Allowing direct gifts from an IRA to a qualified charity serves the same function as a charitable deduction.

The taxpayers who itemize their deductions will also benefit from this new rule if the amount of their desired charitable giving exceeds the adjusted gross income ceilings associated with charitable giving. Under the new law, and within the limitations described above, there will be a perfect match between the amount of the gift and the amount excluded from income, which will not always be the case if the taxpayer simply takes a charitable deduction.

Qualified charities have been actively promoting such distributions from IRAs as a great two-year opportunity for substantial income tax savings.

This new law becomes effective in 2006 and, unless extended, ends after 2007.❖

Receipt for Cash Gifts

According to the Pension Protection Act of 2006, the rule for substantiating cash charitable gifts has become stricter. Under the new law, for cash gifts of any amount, the donor must maintain a record of contribution in the form of a bank record (a cancelled check, a wire transfer acknowledgement, or a credit card record) or a written communication from the donee showing the name of the donee and the date and amount of the contribution. It is important to maintain at least one of these two forms of records since the recordkeeping requirement will not be satisfied by any other written documentation.

This law is effective for contributions made in taxable years beginning after August 17, 2006. Therefore, for calendar year taxpayers, this section of the new law will become effective starting in 2007.

Around the Firm

In October, Jonathan Karp chaired the CPA Education Foundation Closely Held Business Conference and gave a speech on "Exit Strategies." In September, Jon presented "Succession Planning for the CPA Firm" to the Management Consulting Service Committee in Burbank. He also wrote the article "The Insider: Well Planned and Structured Agreement Key to Successful Internal Succession" that was published in the September issue of California CPA magazine.

The firm is a sponsor of the USC Law School 2006 Tax Institute, being held in Los Angeles on January 22-24. The Institute is a leading tax law conference that addresses legislation, critical issues and strategies that impact corporate, partnership, individual, real estate, and trust and estate planning.

Any tax advice contained in this communication (including any attachments) is neither intended nor written to be used, and cannot be used, to avoid penalties under the Internal Revenue Code or to promote, market or recommend to anyone a transaction or matter addressed herein.

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