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Pension Act Provides Small Boost to Charitable Giving

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A few weeks ago this column discussed some of the Pension Protection Act of 2006's major provisions such as the funding private pension plans and changes to the management of 401(k)s. Today's discussion focuses on a very small aspect of that Act – Section 1201, Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes.

This section allows anyone 70 ½ or older to make tax-free distributions directly from their IRA to qualified charities. Distributions are limited to \$100,000 a year and at the current time this provision is only in effect for 2006 & 2007. One important point is that in order for the distribution to qualify as tax-free under this provision, it must be made directly from an IRA to the charity and therefore the time to start planning is now.

These provisions are nice, but I want to be careful not to overstate the benefits. In general, these provisions are only beneficial to moderate income taxpayers who do not itemize their tax deductions and wealthy individuals whose deductions and exemptions may be subject to limitations based on the size of their income or their charitable contributions.

You might ask, why write about this at all? The reason is that my wife and I are very involved with a few charities and if we can help increase awareness, and help raise more money, it is a good thing. I suspect many readers are involved with charities and this might help them increase contributions to their organizations. An even larger number of readers are probably in a position to pass this information along to their parents and friends over 70 ½ who may have missed this section in the 900-page tax bill.

In addition, since all IRA holders aged 70 ½ are required to take distributions, if they contribute anything to charity; it makes sense to understand if the new law can lower their taxes.

As mentioned above, the law benefits taxpayers who make charitable donations and do not itemize their tax deductions. For instance, under the previous regulations, if your marginal tax bracket was 15 percent and you gave \$1,000 of your income to various charities, there was no tax benefit. Under this new law, if you make the contribution directly from your IRA, you can save \$150 in federal income taxes and maybe more in state taxes. Sweet!

There are also benefits for higher-income tax payers who itemize their deductions. Under current law high-income earners are unable to deduct all of their itemized deductions if their income exceeds a certain threshold. In simple terms, for 2006, itemized deductions are reduced by 2 percent of the amount adjusted gross income is over the threshold level.

Let's look at an example using the 2006 threshold of \$150,500 for a married couple and assuming a couple's adjusted gross income of \$250,500. In this case, if their itemized deductions are reduced by 2 percent of the \$100,000 earned over the \$150,500 threshold, this comes to \$2,000. If this couple plans to contribute \$10,000 to charity and now does it directly from their IRA, their adjusted gross income falls by \$10,000. Now their overall itemized deductions get trimmed by \$1,800 rather than \$2,000 for a reduction in taxable income of \$200. This leads to saving of \$70 if one is in the 35% tax bracket. If their charitable contributions were \$50,000, income would decline \$1,000 and savings would be \$350.

In case you are looking for a worthwhile charity, here's one. My wife and I are very involved with National Dance Institute (NDI) in New York City. We have been volunteers for over 25 years and I have been on the Board of Directors for 10 years. Working primarily with inner-city 4th and 5th grade students in the NYC public school system, NDI teaches basic dance to educate students about the arts. In the process we also teach important learning skills like practice, concentration and teamwork to accomplish the goal of performing in front of their classmates and broader community. Classes include all students and our professional teachers help every child succeed. The end result is a feeling of pride in their accomplishments and increased self-confidence. For some students, (especially the "bad boys" in the back row) it is one of their first, but hopefully not their last, positive achievement in school. For more information, check out nationaldance.org.

This article is not designed to offer tax advice and readers should consult a tax expert to discuss their individual tax situation.

In summary, charitable donors over 70 ½ years old should consider if this new law can help them save money. While the savings are not great, every little bit helps. For the rest of us, it is important to understand these provisions so we can help our friends and relatives. It is imperative that older people are not misled by either well-meaning, but uninformed charities or the inevitable con-artists.

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