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Charitable Giving Opportunities Created by KETRA

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The Katrina Emergency Tax Relief Act of 2005 ("KETRA") was enacted to provide assistance, in the form of tax planning benefits, to those affected by the recent hurricanes. However, the new law offers planning opportunities that may be used by many taxpayers. These opportunities relate to the ability to make increased charitable contributions, in an effort to encourage taxpayers to increase giving in general and not just for hurricane relief.

Suspension of Percentage Limits on Charitable Giving Deduction

The ability of individual taxpayers to deduct charitable contributions is limited to a percentage of the taxpayer's income. For most taxpayers and most large charities, the limit is 50% of adjusted gross income. There are other limits, depending on the type of property donated and the type of charity. Amounts contributed in excess of the percentage limit may be carried over to succeeding years. Under the new law, but for a limited time only, "qualified" charitable contributions may be deducted up to the full amount of the taxpayer's adjusted gross income, less the amount deducted for other charitable contributions. Any excess contribution amount would still be carried over to later years, subject to other limitations.

What Are Qualified Charitable Contributions?

Qualified charitable contributions are (1) cash contributions made (2) from August 28, 2005 to December 31, 2005 to (3) a charitable organization that is described in Section 170(b)(1)(A) of the Internal Revenue Code – generally churches, schools, hospitals and other public charities. Donor-advised funds do not qualify, nor do supporting organizations under Code Section 509(a) (3).

Limits on Itemized Deductions

Federal income tax law provides for a reduction of itemized deductions, including charitable contributions, depending on the level of the taxpayer's income. Under the terms of KETRA, the deduction for qualified charitable contributions is not treated as an itemized deduction for purposes of the reduction of itemized deductions. Consequently, the entire amount of such contributions can be deducted on the individual taxpayer's 2005 tax return, up to the limits described above.

(It is important to note that different rules apply to corporate contributions, and that those contributions must be made for relief efforts related to Hurricane Katrina.)

Use of Retirement Accounts

One planning technique that may be considered in view of this change in the law relates to the donation of funds from a retirement plan account or individual retirement account. Many taxpayers have expressed an interest in making contributions of account balances, in whole or in part, to charities. Legislation has been introduced repeatedly in Congress to permit this type of contribution, but it has never been enacted. The new law permits taxpayers to withdraw funds from a retirement account, pay them to a charity, and take a full charitable contribution deduction, up to the limits described above.

There are some possible offsets that apply to the tax benefits of making a gift of retirement accounts assets. First, it is important to keep in mind the state income tax consequences of a gift of an income producing asset to a charity. In those states, such as Pennsylvania, that do not have a charitable contribution deduction, it is important to determine whether the withdrawal from the retirement account is otherwise free of tax.

In addition, the withdrawal from the individual retirement account increases the taxpayer's adjusted gross income. This could affect the calculation of alternative minimum tax and could also result in the reduction of other itemized deductions, as well as the taxation of a larger amount of Social Security benefits. Distributions from a retirement account before age 59½ could result in payment of a 10% penalty.

This planning opportunity can be of great value for those with charitable intentions, but it is important to know all of the tax consequences that flow from it.