Shipman & Goodwin LLP

# Personal Planning Letter

December 2006

IN SUMMARY:



## 2001 MODIFICATIONS TO QUALIFIED TUITION PLANS ("529S") MADE PERMANENT

The Pension Protection Act of 2006 makes permanent earlier temporary legislation allowing certain distributions from qualified tuition programs (known as "529" plans) to be made without income being attributed to the beneficiary.

Under Section 529 as originally passed, donors could make contributions to qualified tuition programs which were not includible in gross income of the donor or the beneficiary at the time of the contribution. However, contributions were included in the taxable income of the beneficiary at the time of distribution of the funds to the beneficiary.

Legislation passed in 2001 provided that until 2010, withdrawals from qualified tuition plans would be tax free if the distribution in a given year did not exceed the qualified tuition costs of the beneficiary. This tax-free treatment was scheduled to end at the end of 2010, after which time distributions would once again be includible in the gross income of the beneficiary at the time of the distribution.

However, the Pension Protection Act of 2006 removes the sunset provision so that even after 2010, distributions from qualified tuition plans will not be included in the gross income of the beneficiary at the time of distribution.

GOOD NEWS!

EFFECTIVE JANUARY 1, 2006, THE MAXIMUM ANNUAL GIFT TAX EXCLUSION WAS INCREASED TO $12,000 PER DONEE.

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## TRANSFER OF ELIGIBLE RETIREMENT PLANS INTO IRAs FOR NON-SPOUSE BENEFICIARIES

The Pension Protection Act of 2006 also permits a non-spouse beneficiary of an eligible retirement plan (for example, a 401K) to transfer that plan to an inherited IRA. This technique potentially provides a substantial tax savings because, in some cases, the transfer to an inherited IRA may increase the period of time over which benefits are paid to the beneficiary, thereby deferring the income tax on the distributions.

To take advantage of this benefit, the transfer must be made from the trustee of the retirement plan directly to the trustee of the IRA which was established for the purpose of receiving the distribution on behalf of the beneficiary. The IRA will be treated as an inherited IRA in the hands of the beneficiary.

## THE NEW OPPORTUNITY FOR GIFTS FROM IRAs COURTESY OF THE PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006 (the "Act") permits individual taxpayers to make certain charitable contributions directly from IRAs. Previously, a taxpayer wishing to make a charitable contribution using IRA funds had to withdraw the funds and pay income tax associated with the withdrawal and contribute the net amount to charity. Under the Act, contributions directly from the IRA to the charity are not taxed as income to the taxpayer.

For a charitable contribution from an IRA to qualify, certain requirements must be met.

- The individual making the contribution must be at least 70 1/2 years of age on the date of the contribution.
- The Act only applies to contributions of up to $100,000 per individual per year. Any contributions from an IRA over that amount are treated as taxed withdrawals which are then donated to charity.
- The Act applies only to contributions from traditional IRAs and Roth IRAs.
- The contribution must be DIRECTLY from the IRA to the charity; if it passes through the holder of the IRA or anyone else, it will be treated as a taxed withdrawal which is then donated to charity.
- The charity must be a public charity or a private conduit foundation; contributions may not be made to donor-advised funds or supporting organizations.
- The ENTIRE contribution must be otherwise deductible under Section 170 of the Internal Revenue Code; if the donor receives consideration for part of the gift, the entire gift will be disqualified from receiving favorable treatment under the Act.
- The contribution must be made after 12/31/05 and before 1/1/08.

The Act will benefit individuals who are over 70 1/2 with traditional IRAs or Roth IRAs who (1) have already used (either directly or via carry-over) their entire charitable deduction allowed under Section 170 of the Internal Revenue Code during the taxable year; (2) want to make charitable contributions but do not itemize deductions; or (3) have income above the applicable threshold such that deductions under Section 170 of the Internal Revenue Code are not "dollar for dollar" deductions.

**EXAMPLES:**

**John is 75 years old and has a traditional IRA, from which he is required to take a distribution this year of $10,000. His income from all other sources is $70,000 per year; and prior to his recent retirement, he made large charitable contributions. He has carry-over from past charitable contributions in excess of 50% of his income. He would like to make a charitable contribution of $10,000 this year.**

- OPTION 1 – John takes the $10,000 distribution from the IRA, *pays income tax on it*, then gives it to charity, and cannot take any deduction for the charitable contribution because he has already exhausted his charitable contribution deduction.
- OPTION 2 – John directs his plan administrator to make a $10,000 contribution to the charity of his choice. This fulfills his distribution requirement yet *he pays no income tax* on the $10,000 as he did under option 1.
- Under both options, John is denied the deduction under Section 170, yet under option 2, he avoids paying income tax on $10,000.

**Mary is an 80 year old widow of modest means. She has an IRA and other income of approximately $50,000 per year. She does not itemize deductions, yet she makes yearly contributions to her church of approximately $5,000 per year.**

- OPTION 1 – Mary takes her required distributions from her IRA each year, *pays income tax* on them, donates to her church and takes no deduction for the church donations.
- OPTION 2 – Mary directs her plan administrator to make a yearly contribution of $5,000 from her IRA to the church. *She does not pay income tax* on the $5,000.
- Under both options, Mary gets no deduction under Section 170, yet under option 2, she avoids paying income tax on the $5,000.

**Anita and Joe are married; each is 77 years old. They file a joint income tax return. Anita has a traditional IRA. Together, their other income is approximately $400,000 per year. Anita is required to take a $15,000 distribution from her IRA this year and also wants to make a charitable contribution of $15,000.**

- OPTION 1 – Anita takes the distribution of $15,000, then donates $15,000 to charity. Anita and Joe are permitted to take a deduction of $10,010 for this contribution. They *pay income tax on $4,990 of the $15,000 distribution, even though they donated the entire amount to charity.*
- OPTION 2 – Anita directs her plan administrator to pay the charity $15,000 directly. She *does not pay any income tax on any portion of the contribution.*
- Under both options Anita and Joe are rewarded for their charitable contribution; however, because they are above the income threshold, under option 1, they must pay tax on a portion of the income.

**Alex is a 78 year old with an IRA of $100,000. He has other income of $300,000 and does not need the IRA. In fact, he has been taking the minimum required distributions each year and paying the corresponding income tax, which is high because of his high income tax bracket. He plans to give the IRA to his favorite charity upon his death.**

- OPTION 1 – Alex continues to take the required minimum distributions each year, diminishing the value of the IRA, and *paying income tax on each distribution.*
- OPTION 2 – Alex directs his plan advisor to contribute the entire amount held in the IRA, $100,000, to the charity immediately. The charity benefits by immediately receiving the full value of the IRA, and Alex *no longer has to pay income tax on required distributions.*
- Under both options, Alex's favorite charity benefits. However, under option 1, Alex must pay income tax on minimum distributions that he does not need; under option 2, he avoids paying the income tax and his charity has immediate use of the funds.

## STATUTORY CHANGES REGARDING HEALTH CARE INSTRUCTIONS

Recent legislation passed by the Connecticut General Assembly permits an individual to appoint a single health care representative who will have authority to make all health care decisions for the individual. Prior to passage of this law, two documents were required to delegate powers regarding health care decisions - an appointment of health care agent, for decisions regarding life support and other life and death decisions, and a power of attorney for health care, for routine medical decisions. Under the new legislation an appointed health care representative will make both types of health care decisions.

It should be noted that despite these statutory changes, appointments of health care agents and powers of attorney for health care signed prior to October 1, 2006 will continue to be effective. Therefore, there is no urgency in executing new health care documents, but the documents should be updated as part of your general estate plan review.

## QUALIFIED CONSERVATION CONTRIBUTIONS AND THE PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006 expands the charitable deduction for certain qualified conservation contributions made before the end of 2007.

A qualified conservation contribution is a contribution of a real property interest, such as a remainder interest or a restriction on the use of property, to a qualified organization, exclusively for conservation purposes, including preservation of land for recreation, preservation of a natural wildlife habitat, or preservation of open space. Previously, a qualified conservation contribution was treated like other charitable contributions; because such property is generally considered a capital asset, a charitable deduction for up to 30% of the donor's contribution base was permitted (after taking into account other charitable donations made during the taxable year). Additionally, any excess over the permitted deduction limitations could be carried forward for 5 years following the contribution.

The Act permits individuals to make qualified conservation contributions and take deductions of up to 50% (rather than 30%) of their charitable contribution base, with the excess carried forward for 15 years (rather than 5 years). Additionally, certain farmers and ranchers can make qualified conservation contributions and take deductions for up to 100% of their contribution base, provided that the property contributed is used in agriculture or livestock production and the contribution is subject to a restriction that the property continue to remain available for agriculture or livestock production. Also, excess deductions may be carried forward for 15 years.

In addition to the above changes, deduction limitations for certain qualified conservation contributions by certain corporate farmers and ranchers have been increased.

## NEW PARTNER

*We are pleased to announce that Robert L. Teicher has joined the firm as a partner in the Trusts and Estates Department. A former principal at Brody, Wilkinson and Ober, P.C. in Fairfield County and resident in our Greenwich office, Rob's practice encompasses estate and tax planning, trust and estate administration, business tax counseling, and tax controversies.*

*Rob is admitted to practice in Connecticut and New York. He is a member of the American Bar Association, the Connecticut Bar Association Executive Committee of the Tax Section, and the New York State Bar Association. He is also a member of the Society of Trust and Estate Practitioners.*

*In addition, Rob is an active member of the community. He currently serves as Vice Chairperson of the Board of Directors of Jewish Family Service of Bridgeport. He also serves on the Board of Directors of Congregation Beth El in Fairfield.*

## TRUST & ESTATE EVENTS

*The members of our group are frequently asked to speak on trust and estate topics. Recently, Lyn Gammill Walker addressed The Planned Giving Group of Connecticut regarding a new opportunity for gifts from IRAs. In November, she attended the Association of Fundraising Professionals Philanthropy Day Conference where she spoke on the benefits of starting a bequest program and how to use the Leave a Legacy program. Meanwhile, Bryon Harmon has accepted an Adjunct Professor position at Western New England College School of Law. Bryon teaches a course on the generation-skipping transfer tax in the LL.M. Program in Estate Planning and Elder Law.*

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The Personal Planning Letter is published by the **Trusts & Estates Department** of Shipman & Goodwin with the cooperation and assistance of the firm's **Real Estate, Business and Tax** practices.



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