THE IRA CHARITABLE ROLLOVER
A Tax Proposal with Many Benefits

“Under current law, withdrawals from Individual Retirement Accounts are subject to income tax. This creates a disincentive for retirees to contribute some or all of their IRA funds to charity. Thus, President Bush supports legislation that would permit individuals over the age of 59 to contribute IRA funds to charities without having to pay income tax on their gifts.”


AAU endorses the modification of current tax law affecting Individual Retirement Accounts (IRAs) to enable taxpayers to donate IRA proceeds to charities, including universities, tax-free. President Bush included this proposal in his original tax plan, which was initially released during the 2000 presidential campaign. The proposal was included again in the President’s budget proposal submitted to Congress in February, 2002. On February 8, 2002, Senators Joe Lieberman (D-CT) and Rick Santorum (R-PA), along with 8 other co-sponsors, introduced S. 1924, which includes the IRA charitable rollover proposal along with several other incentives for charitable giving.

How does current law treat charitable gifts made from IRAs?

Individuals may withdraw funds from a traditional Individual Retirement Account (IRA) without incurring an early withdrawal penalty once they reach age 59½, although the withdrawals will be taxed as ordinary income. Under the so-called minimum distribution rules, an individual must begin making withdrawals by April 1st following the year in which he or she reaches age 70½. In either case, when a donor withdraws IRA funds in order to make a charitable gift, he or she will pay income tax on the withdrawal, offset to varying degrees by a charitable deduction for the gift. The charitable deduction is limited by current-law restrictions, such as the percentage of Adjusted Gross Income (AGI) limitation on charitable deductions, and the 3% floor on all itemized deductions. If an individual does not itemize on his or her income tax return, no charitable deduction can be taken. As a consequence, very few individuals donate IRA funds to charity during their lifetimes.

Why do donors want to give some of their IRA assets to a charity?

Through careful investing over a long period of time, many individuals have more than sufficient funds to retire comfortably. In addition, individuals are encouraged under the current tax laws to liquidate their IRAs during their lifetime since their estates will face confiscatory tax rates of up to 80% if their IRA funds are left to a dependent or family member (other than their spouse). Under current law, any amounts left in an IRA when an individual dies may be taxed as income to the beneficiary, and are also considered assets for the purposes of calculating that individual’s estate tax liability.

How would the proposal change these rules?

If the proposal were enacted, a donor who had reached age 59½ would be allowed to exclude any IRA funds withdrawn and transferred to a charity from his or her income when filing a tax return for that year. The donor would be eligible to claim a charitable deduction only to the extent that the IRA was funded with after-tax dollars.
What are the advantages of the proposal?

The individuals and communities served by the nation’s charitable sector will benefit from the proposal because the proposed change will encourage a significant amount of new contributions from individuals who would no longer have to pay tax on a charitable gift of IRA funds. These contributions will support programs for those less financially well off through important services, such as those provided by health, education, social service, and cultural organizations. Also, increased giving to charities will expand needed services that the government might otherwise be called upon to provide.

What is an example of how this proposal would work?

Mr. Smith, age 60, has accumulated approximately $1,000,000 in his IRA and other qualified retirement plans. Although he believes he will only need about $750,000 of these funds for his retirement, he plans to leave his IRA intact for another 10 years rather than pay the tax on withdrawal of assets as required under current law.

If legislation is enacted allowing IRA charitable rollovers with favorable tax treatment, Mr. Smith can transfer IRA funds he will not need for retirement to a charity. These funds will not be subject to tax. His gift would be tax-deductible only to the extent that he had previously funded his IRA with after-tax dollars.

What is the revenue estimate for the proposal?

The Bush Administration has estimated that their proposal will cost $2.632 billion over 10 years.