

KATRINA EMERGENCY TAX RELIEF ACT OF 2005

H.R. 3768, Signed into law by President Bush on Friday, September 23, 2005

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CHARITABLE GIVING INCENTIVES - Temporary Suspension of Limits for Certain Charitable Deductions (Sec. 301 of the Act) - Charitable cash gifts made by individuals to any public charity (with 2 exceptions) for any charitable purpose between Aug. 28, 2005 and Dec. 31, 2005 will not be subject to the 50% annual charitable deduction limitation, nor will the deduction be reduced if the donor has income over \$146,000 and is subject to the 3% phase-out for itemized deductions. The 2 exceptions are gifts to a Sec. 509(a)(3) supporting organization and contributions to a donor advised fund. Gifts to private foundations and gifts of publicly traded stock also do not qualify for the exception. Charitable cash gifts made by corporations to a public charity during the same time period will be exempt from the 10% corporation limitation, but only if used for Hurricane Katrina relief.

THIS IS NOT THE EQUIVALENT OF CHARITABLE IRA ROLLOVER - Please be very careful advocating IRA withdrawals to make bigger gifts. At first, many of us thought that this could be close to "Charitable IRA Rollover." People could withdraw huge amounts of cash from their retirement accounts and then transfer them as outright (not deferred) gifts to a charity with a 100% offsetting income tax deduction. No income tax, right? Wrong. There can be federal tax consequences for people with income over \$146,000 and there can be state tax consequences at any income level. People with income over \$146,000 who withdraw cash from their IRAs and give it to a charity will pay roughly a **1% to 2% federal income tax**. That's not much, but it could make for angry donors who thought that there would be no income tax problem at all. Also, donors who live in **Indiana, Massachusetts, Michigan,* New Jersey,* Ohio** and perhaps other states could have serious state income tax problems if increased IRA withdrawals are given to charities. These states tax IRA withdrawals* but give residents no offsetting charitable deduction.

HOW IS THERE A 1% TAX? - Here is how to explain to a rich person what normally happens when she withdraws money from a retirement account and gives it to charity: (#1): You increase your income by a \$100 withdrawal from your IRA, (#2) you make a charitable gift of \$100, (#3) if your income is over \$146,000, you have to reduce your itemized deductions by 3% of the extra \$100 of income, or by \$3, which means (#4) that for your \$100 gift, you (normally) deduct only \$97. You lose a \$3 tax deduction. The loss of \$3 multiplied by your 33% tax rate translates to a 1% tax on the charitable gift that you made from your retirement account.

* Some retirement income is tax-free in **NJ & MI** \$15,000 (\$20,000 married) in NJ & \$38,550 (\$77,100 married) in MI; excess is taxable. **Illinois & Pennsylvania** no charitable deduction, but all retirement income is tax-free.

THE NEW LAW - The protection in the legislation from the 3% cutback on itemized deductions applies to the *charitable gift*. You will indeed be able to deduct the full amount of these new charitable gifts, even if the 3% phase-out eliminates all of your other itemized deductions. The problem comes from taking money out of your IRA to make these gifts. Withdrawing money *increases your income* and the 3% phase-out starts gnawing away at your *other* itemized deductions (state & local taxes, etc.), even if your charitable deduction is safe.

**IMPACT OF HURRICANE KATRINA TAX ACT ON CHARITABLE GIFTS
FUNDED WITH LARGE RETIREMENT PLAN WITHDRAWALS
(Impact of Waiver of 50% Annual Charitable Deduction Limitation and
Exemption of Charitable Deduction from the 3% Phase-out for Itemized
Deductions)**

-- THE NORMAL RULES (Gifts Made Before Aug. 28, 2005) --

Married Couple with Adjusted Gross Income ("AGI") of \$200,000.

\$23,600 of itemized deductions - 3% phase-out begins at \$146,000 <<Assume over age 59 1/2
Two personal exemptions of \$3,200 - phase-out begins at \$219,000 to avoid 10% penalty >>

IRA distribution to charity		\$10,000	\$100,000	\$200,000	\$500,000	\$1,000,000
New Adj. Gross Income ("AGI")		\$210,000	\$300,000	\$400,000	\$700,000	\$1,200,000
	<u>No Gift</u>					
Itemized	23,600	23,600	23,600	23,600	23,600	23,600
Charit Ded (Max 50% AGI)		10,000	100,000	200,000	350,000	600,000
Charit Carryfwd		0	0	0	150,000	400,000
Pers Exemp	6,400	6,400	2,060	0	0	0
3% cutback	-1,720	-2,020	-4,720	-7,720	-16,720	-31,720
Taxable Income	171,720	172,020	179,060	183,920	342,920	607,920
Tax	\$38,040	\$38,123	\$40,114	\$41,718	\$94,665	\$187,415
Cost of Gift		\$83	\$2,074	\$3,678	\$56,625	\$149,375
Cost as % of Gift		0.8%	2.1%	1.8%	11.3%	14.9%

- HURRICANE KATRINA TAX ACT -
 -- GIFTS MADE BETWEEN AUG. 28 and DEC. 31, 2005 --

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	<u>No Gift</u>				
Itemized	23,600	23,600	23,600	23,600	23,600**
Charit Ded (100%)	10,000	100,000	200,000	500,000	1,000,000
Charit Carryfwd	0	0	0	0	0
Pers Exemp6,400	6,400	2,060	0	0	0
3% cutback	-1,720	-2,020	-4,720	-16,720	-18,880**
Taxable Income	171,720	172,020	179,060	183,920	195,280
Tax	\$38,040	\$38,123	\$40,114	\$41,718	\$44,688
Cost of Gift	\$83	\$2,074	\$3,678	\$6,648	\$7,414
Cost as % of Gift	0.8%	2.1%	1.8%	1.3%	0.7%

** There's a limit to the 3% phase-out: No more than 80% of regular itemized deductions can be eliminated.