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The Financial Planning Newsletter

Wesling Financial Planning Services

Achieving Your Life's Goals through Financial Planning

Estates Transferring IRA Assets to Charities Avoid Taxes. In two Private Letter Rulings (PLRs), the IRS ruled the direct transfer of assets from IRAs to charities avoided taxes for the donating entities. In PLR 200633009 and PLR 200617020, the IRS addressed the taxation of assets moved from IRAs that were part of an estate to charities. The IRS agreed the act of making in-kind distributions did not cause the estate to recognize any income taxes. The key to both decisions was the direct transfer from the estate to the charity.

While using IRA assets to fulfill charitable intents is often a wise course, naming an estate as the beneficiary of an IRA can be unwise. It generally makes no sense to assume the burden of the cost of administering the IRA through an estate. Instead, use the beneficiary designation on the IRA form to name the charity. This achieves the same goal without the cost.

Two New 10% Penalty Exceptions. Prior to the Pension Protection Act (PPA) of 2006, the only ways to take money out of an IRA while avoiding the 10% penalty were:

- Death or disability of the IRA owner,
- Payment of certain medical expenses,
- Paying higher education costs for certain individuals,
- First time home purchase, limited to $10,000, and
- The 72(t) approach, substantially equal periodic payments.

With the passage of the PPA of 2006, Armed Forces reservists activated for more than 179 days after September 11, 2001 to December 31, 2007 can avoid the 10% penalty on IRA distributions taken before reaching age 59½. The withdrawal provision is retroactive to September 11, 2001. Reservists can submit an amended return for penalties paid in prior years. The amended return must be filed by August 17, 2007.

Further, reservists are allowed to repay any distributions taken between September 11, 2001 and December 31, 2007. Repayments can be made up to two years after the end of their active duty or August 17, 2008, whichever is later. Repayments have no effect on annual contributions, but the repayments are not tax deductible. This means these taxpayers will have to keep track of the cost basis of their IRA investments. Some people might see this as a real headache. But, in reality it's not difficult to do; taxpayers can use IRS Form 8606 to track their basis.

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The other new 10% penalty exception provided by PPA 2006 is for public safety employees separating at age 50 or older. This exception applies to distributions from governmental defined benefit pension plans taken after August 17, 2006, but this exception is for pension plans, not IRAs.

PPA 2006 Makes Permanent Many Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001. The following are some familiar provisions in the current tax law that were set to sunset and disappear after 2010. The PPA 2006 makes the following provisions permanent:

- Catch-up IRA contributions for those over age 50,
- Increased traditional and Roth IRA contribution limits,
- Sixty day rollover rule is waived for hardship cases,
- Roth 401(k) and Roth 403(b),
- Employer plan contribution limits are increased and adjusted for inflation,
- Small business pension start-up credit, and
- Saver's credit for low income taxpayers.

Roth Conversions and the Tax Increase Prevention and Reconciliation Act. For those who really like to plan into the future, a golden opportunity may exist beginning in 2010 for traditional IRA holders. Currently, conversions from a traditional IRA to a Roth IRA are available only to those with an adjusted gross income (AGI) of $100,000 or less. However, starting in 2010, there will be no income restrictions for Roth conversions. Depending on an individual's situation, the conversion opportunity may prove immensely useful for many traditional IRA holders.

Year-End Planning. If you have a 401(k) plan at work, now's the time to adjust your 2007 contribution amount. Put aside as much as you can stand, try for the max of $15,000 per year ($20,000 if age 50 or older). This advice goes double if your employer makes matching contributions. Also, this is the time of year when you specify how much of your salary you will contribute to your medical and child-care flexible spending accounts.

As for the increasing possibility of having to pay the dreaded AMT, if your income is over about $75,000, if you have significant write-offs for personal exemptions, state and local income and property taxes, or interest on a home equity loan not used to improve the house, you might be an unsuspecting victim. The same is true if you exercised incentive stock options or had significant realized capital gains. When it applies, the AMT is an add-on tax over and above your "regular" tax amount.

Taxpayers in the "AMT mode" may find the time-honored advice about prepaying state and local taxes before year's end will not actually reduce their federal income tax bills at all because these taxes are nondeductible for AMT purposes. If so, don't prepay.

As Albert Einstein stated, “Not everything that can be counted counts, and not everything that counts can be counted.”

Have a great holiday season and an even better 2007!