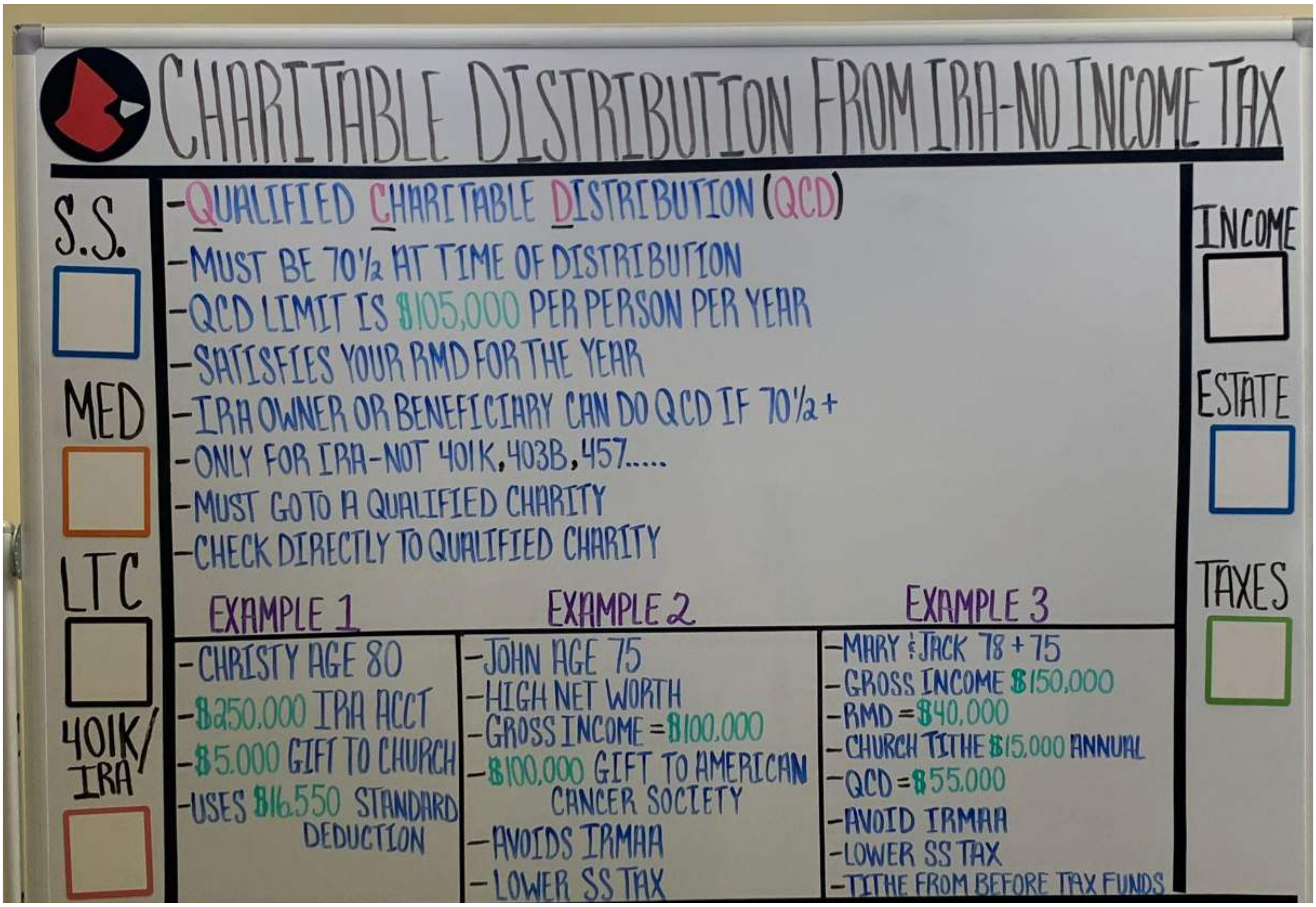
CARDINAL ADVISORS

# Charitable Distribution From IRA-No Income Tax

In the video entitled "Charitable Distribution From IRA-No Income Tax" Hans and Tom use the following documents to discuss IRA's.






Aug 2024

# Navigating Qualified Charitable Distributions in 5 Easy Steps

## What is a qualified charitable distribution (QCD)?

A QCD is a distribution from an IRA that goes directly to a qualifying charity and is not included in the taxable income of the IRA owner. A QCD cannot be made from an employer plan. A QCD can be up to $105,000 for 2024, per individual.

1. **Either an IRA owner or a beneficiary can do a QCD.** The individual *must* be at least age 70½ at the time of the transaction. Reaching age 70½ later in the year is not enough. Both spouses can do a QCD when each spouse does the QCD from their own IRA.

2. **A QCD can be made from an IRA, an inactive SEP or SIMPLE IRA, or a Roth IRA.** Only pre-tax amounts can be used for a QCD, which makes the use of Roth funds very unlikely. The QCD must be a direct transfer to a qualifying charity. A check payable to the charity but sent to the IRA owner will qualify as a QCD, as will a check written from a "checkbook IRA" to a qualifying charity. If an IRA owner receives a check payable to him from his IRA and then later gives those funds to charity, that is not considered a QCD.

3. **A charity must be a qualifying charity.** It cannot be a donor-advised fund or a private foundation. For 2024, a QCD of up to $53,000 to a split interest entity such as charitable gift annuity, charitable remainder unitrust, or a charitable remainder annuity trust is allowed. QCDs to split interest entities may only be done in one year of an individual's lifetime. A QCD to a charity where the IRA owner has an outstanding pledge will qualify and will not create a prohibited transaction. The QCD must satisfy all charitable deduction rules. If a distribution to a charity is more than $105,000, the amount over $105,000 is taxable to the IRA owner and is deductible on the owner's income tax return. The excess amount cannot be carried over to a future tax year.

4. **A QCD can satisfy a required minimum distribution (RMD) but can be made before age 73.** It is not limited to the amount of the RMD, but is capped at $105,000 a year. If an RMD is more than $105,000, any amounts in excess of the QCD are taxable to the IRA owner. QCDs can now be made before the first RMD year (age 73).

5. **The IRA custodian has no special tax reporting for a QCD.** The QCD will be reported on Form 1099-R as a regular distribution. The IRA owner will need to report the QCD on his tax return. The amount of the QCD is excluded from the owner's taxable income. The IRA owner also cannot take a charitable deduction for the QCD amount.

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# Think About It

## What Financial Professionals Need to Know About Qualified Charitable Distributions (QCDs)

AN ADVANCED UNDERWRITING CONSULTANTS NEWSLETTER BY LINAS SUDZIUS AND JENNIFER LOLLAR

# What Financial Professionals Need to Know about Qualified Charitable Distributions (QCDs)

## INTRODUCTION

When we work with clients, we aim to help them achieve the financial goals that are relevant to them. Some may prioritize retirement planning. For others, maximizing the amount of wealth passing to the next generation might be most important. A few may be especially worried about protecting assets from the claims of creditors.

In our experience, those who believe they have adequately addressed personal and family financial objectives may be interested in supporting philanthropic causes through charitable giving. We may be able to help them support their preferred charities by helping implement a variety of strategies, including:

- Naming a charity the beneficiary of a qualified account or nonqualified annuity
- Encouraging transfers to charity language in the client's will or trust
- Administering a charitable remainder trust

One of the simplest ways for an eligible client to support a charity is through the qualified charitable distribution (QCD) technique. While QCDs have been available for nearly 20 years, we believe they are still underused. Few lifetime charitable giving techniques are as tax efficient as QCDs.

The rules surrounding QCDs have been tweaked as a result of the SECURE Act 2.0, so now is a good time to review how QCDs work, discuss giving alternatives, and review the most recent changes.

## QUALIFIED CHARITABLE DISTRIBUTIONS

### Background

The Pension Protection Act of 2006 (PPA) provided that for tax years 2006 and 2007 only a person aged 70½ or older could make charitable gifts directly from his/her IRA of up to $100,000 per year without having to report it as taxable income. Any such gift would count toward the taxpayer's required minimum distribution obligation.

Under the PPA provision, in order to escape inclusion in income, the gift had to meet certain requirements to be a qualified charitable distribution (QCD). Those requirements were:

- The transfer was made after the actual date the taxpayer attains age 70½; it was not sufficient to be in the year in which age 70½ is attained.
- Transfers had to come from IRAs only, not other qualified plans.
- The transfer had to be made directly from IRA custodian to charity; the taxpayer could not have receipt of the money, either actual or constructive.
- The transfer had to be made directly to a public charity; transfers to donor-advised funds or 509(a)(3) organizations would not qualify.
- The transfer would otherwise fully qualify for a charitable tax deduction. Charitable gift annuities or charitable trust gifts would not qualify.

Since its original enactment, the QCD strategy's life was temporarily extended several times before Congress and the president made the technique a permanent part of the tax code in 2015. The original rules were left largely intact with a few exceptions we will discuss later.

One unchanged aspect of QCDs that surprises some is that the age at which distributions may begin has stayed 70½. This is true even though the RMD age has increased to 73 and will increase again to age 75 in the future.

## Advantages of QCDs

The attorneys at Advanced Underwriting Consultants often get asked about the advantages of QCDs. The client and financial advisor want to know why using the technique is necessary when the client could take a regular distribution from the IRA and then write a check for the same amount to charity.

The answer is that the QCD allows a person who would not otherwise be able to take full advantage of a charitable deduction to avoid recognizing the income. There may also be other ways a manual distribution's effect on gross income might negatively impact the client.

Here are two examples that illustrate the advantages of QCDs over manual gifts using IRA money:

> Example 1: Christy Thomas (80) is a single taxpayer with a $250,000 IRA account. She intends to make a $5,000 gift to her church. She does not itemize on her income tax return, choosing instead to claim the $16,550 standard deduction available to those over 65 who are single in 2024.
>
> If Christy uses the QCD technique to make her gift to her church, the $5,000 does not increase her taxable income at all.
>
> If Christy takes a manual distribution, she will increase her taxable income by $5,000. She will not get an offsetting charitable deduction because she claims the standard deduction instead of itemizing.
>
> Example 2: John Clauss (75) is a high-net-worth single taxpayer who has been careful to limit the amount of his taxable income in retirement. John itemizes deductions on his tax return. John's gross income is expected to be about $60,000 in 2024.
>
> John would like to donate $100,000 of his IRA money to the American Cancer Society. If he uses the QCD technique to make the gift, it will not increase his taxable income at all. Furthermore, a QCD will not increase his Medicare income-related monthly adjustment amount (IRMAA) income, which if increased by $100,000 might also increase his Medicare Part B premiums.
>
> If John takes a manual distribution, he will increase his gross income by $100,000. That would make his total gross income $160,000. Since John itemizes, he can claim a charitable deduction. However, that income tax deduction is limited to 60 percent of his gross income—$96,000 in this example.
>
> Finally, the itemized deduction will not help John with his IRMAA. The full amount of the $100,000 distribution will be included in his IRMAA calculation.

The two examples illustrate that when given a choice of QCD versus manual distribution followed by charitable gift, the QCD is to be preferred.

## The QCD Process

The rules make clear that a QCD is a nontaxable distribution if made directly by the custodian of an IRA to an organization eligible to receive tax-deductible contributions. The account owner must be at least age 70½ when the distribution was made.

Notice 2007-7 says that the IRS will allow a QCD on an IRA distribution check that is subsequently hand delivered by the IRA owner, as long as the check was payable to the charity. See https://www.irs.gov/pub/irs-drop/n-07-07.pdf.

While QCDs are tax-free distributions, they are reportable on Form 1099-R by the payer. The IRS, in its instructions for Form 1099-R, says "There is no special reporting for qualified charitable distributions under section 408(d)(8)." As a result, the Form 1099-R connected to a QCD will most likely indicate that the distribution was taxable and will show that a distribution code of 1, normal distribution.

It is up to the recipient to reconcile the difference on the taxpayer's income tax return. Here's how the IRS says to do that:

> Like other IRA distributions, QCDs are reported on Line 4 of Form 1040 or Form 1040-SR. If part or all of an IRA distribution is a QCD, enter the total amount of the IRA distribution on Line 4a. This is the amount shown in Box 1 on Form 1099-R.
>
> Then, if the full amount of the distribution is a QCD, enter 0 on Line 4b. If only part of it is a QCD, the remaining taxable portion is normally entered on Line 4b.
>
> Either way, be sure to enter "QCD" next to Line 4b.
>
> https://www.irs.gov/newsroom/qualified-charitable-distributions-allow-eligible-ira-owners-up-to-100000-in-tax-free-gifts-to-charity

The IRS also reminds taxpayers that they need to get confirmation from the charity regarding the charitable gift:

> QCDs are not deductible as charitable contributions on Schedule A. But, as with deductible contributions, the donor must get a written acknowledgment of their contribution from the charitable organization before filing their return.
>
> In general, the acknowledgment must state the date and amount of the contribution and indicate whether the donor received anything of value in return.

### Also Available for Inherited IRAs and Roths

The QCD strategy is also available for inherited IRA accounts and Roth IRAs. In both cases, the current owner of the account must be 70½ or older to take advantage of the technique.

QCDs have the same advantages with respect to inherited IRAs as those enjoyed by living owners of traditional IRAs:

- QCD distributions do not hit the client's taxable income at all, and
- QCDs go toward satisfying the annual RMD obligation.

While it is possible for a Roth account owner to use Roth money for a QCD, the nature of the Roth IRA account undercuts the usual advantages for charitable distributions. In most cases, Roth distributions—if taken in cash—would be tax-free. Furthermore, living Roth IRA account owners have no annual RMD obligations. With those pluses gone, it's hard to know why most taxpayers would choose to do QCDs from Roth IRAs.

### Not Available for Active SEPs, SIMPLEs, or Other Qualified Accounts

QCDs may not be made from SEP IRAs or SIMPLE IRAs that have accepted contributions for the year. Charitable distributions may be made from SEPs or SIMPLEs that are not being contributed to.

To date, the federal government has not extended the scope of QCDs to other qualified accounts, such as 401(k)s or 403(b)s. When clients understand this limitation, they sometimes seek to do a plan rollover and do a charitable distribution once the money is parked in an IRA.

While the rollover and subsequent QCD pairing technique can work, it does not solve the problem in the following example:

> Kent is 75 and has $500,000 in a 401(k) account with his former employer. He has no IRA balances but would like to use the QCD technique to give $25,000 to The Rotary Foundation. He plans to perform the rollover now and then make the charitable distribution prior to the end of the year. He hopes the QCD will satisfy his minimum distribution obligation.

While Kent can do a QCD from his IRA post-rollover, it will not satisfy the RMD due from his 401(k) account for 2024. The RMD due from his 401(k) account would not be eligible for rollover, and any IRA QCD distribution would not count toward his 401(k) RMD obligation.

### Changes to QCDs

The original SECURE Act increased the age at which RMDs must begin for some taxpayers. However, the age at which QCDs are available was left at age 70½.

Likewise, the SECURE Act 2.0 increased the RMD age without changing the QCD starting date. The SECURE Act 2.0 also made two significant changes to QCD rules.

## COST OF LIVING

For the first time, the SECURE Act 2.0 has indexed the QCD contribution limit to the cost of living. As a result, the maximum amount a taxpayer may contribute directly from an IRA to charity in 2024 is $105,000.

## SPLIT INTEREST GIFT OPPORTUNITY

SECURE 2.0 creates a one-time lifetime opportunity to give up to $50,000 to a "split-interest entity" through the QCD technique. Split-interest entities include charitable remainder trusts (CRTs) or a charitable gift annuity (CGA).

Under a CRT, the donor usually receives an income stream for life or for a stated number of years, after which the remainder interest, the amount left in the trust at the donor's death, passes to the charity.

If properly implemented, a CRT creates several tax benefits for the donor:

- No capital gains tax is generated on the sale of appreciated assets after they have been donated to the CRT.
- The donor receives an immediate charitable income tax deduction equal to the value of the donation minus the present value of the annuity stream.
- The donor's estate receives a future estate tax deduction for the value of the charitable remainder interest.

There are two significant drawbacks to consider when considering a strategy involving a CRT, especially if the size of the gift is limited to $50,000:

1. The key first step in creating a CRT is drafting the trust itself. That usually costs a significant amount of money and takes time in a lawyer's office. Not everyone loves those ideas.

2. CRTs also require a fair amount of accounting and legal attention as they are being administered. That will take either the client's time and effort or will involve hiring a professional administrative team. The expenses associated with either choice are high and should be considered before any implementation starts.

Furthermore, directing a QCD contribution to an existing CRT is not possible, as Section 307 of SECURE 2.0 requires the QCD deposit be made into a "trust . . . funded exclusively by qualified charitable distributions."

If a CRT is not a realistic target for the QCD-oriented split-interest gift, what about a charitable gift annuity? Like a CRT, a CGA pays an income stream to the donor, and the charity is able to keep the rest of the donation. Unlike a CRT, the CGA is set up and administered by the charity—removing the downsides of expense and hassle.

What about the drawbacks of CGAs?

- The CGA is less flexible from an income-design perspective than a CRT. The charity decides on the income stream it is willing to offer the donor in exchange for the gift. In general, the charity will target an income stream that has a present value of about half of the initial gift.

- While the donor is able to keep a measure of control over CRT assets, especially if the donor (or someone in the donor's family) acts as trustee of the CRT, the donor has little or no control with a CGA plan over what happens to the asset once it is donated to charity.

- The charity's promise to pay the CGA income stream is unsecured. If the charity runs out of money, a donor may lose out on the promised income stream.

There may be situations where a client is interested in making a QCD gift to a charity of up to $50,000 in exchange for a relatively small annual income stream through a CGA arrangement. We would expect anyone taking advantage of the SECURE Act 2.0's provision on QCD split gifts to limit themselves to considering QCDs.

## Alternatives to QCDs

There are relatively few tax-efficient alternatives to QCDs for making charitable gifts from IRAs or other qualified accounts. In general, taxpayers must take taxable distributions from their IRAs, realizing an income-tax result, prior to making a charitable gift. One exception to this is the limited opportunities created by the SECURE Act 2.0 to make QCD gifts from IRAs to CRTs or CGAs that we discussed earlier.

In our opinion, the most efficient non-QCD way to make a charitable gift using an IRA (or other qualified account) is to name a charity a beneficiary of the funds. While there is no income tax benefit for the current account owner in naming a charitable beneficiary, the following tax efficiencies exist:

- The charity won't pay income tax on the amount received. Qualified funds left to family beneficiaries are generally subject to income taxes at the beneficiaries' tax rates. Monies left to charity are not taxable because the charity is not a tax-paying entity.

- There are fewer limits on the amounts that may be left to charity or on the types of charitable organizations that may be targeted.

- Amounts directed to charity at death from a qualified account are eligible for an estate tax deduction.

Many estate-planning attorneys recommend that their clients control their testamentary charitable intentions with beneficiary designations on their qualified accounts. To take care of family members, they can choose assets with better post-death tax advantages such as life insurance or capital assets with stepped-up basis.

## CONCLUSION

Few lifetime charitable giving techniques are as tax efficient as QCDs. We strongly believe that those who are older than 70½ and who have IRA balances should consider employing the QCD technique for all their charitable giving—if all giving is not more than $105,000 in 2024.

While two rules affecting QCDs have been tweaked as a result of the SECURE Act 2.0, in our opinion these will have little immediate impact on clients. The $50,000 lifetime split-interest gift possibility is unlikely to be used much. While it's nice to have the annual QCD contribution limit increased by cost-of-living adjustments, the annual increases aren't likely to be of much help.

Having said that, now is a good time to educate our clients about QCDs. The QCD story is a good one. Through proper use of QCDs, many of our clients can:

- Satisfy some or all of their RMD obligations,
- Avoid any income-tax implication at all,
- Use the technique to help control Medicare Part B premium, and
- Maximize financial help to causes of their choice.