Qualified Charitable Distribution

When the owner of a traditional IRA reaches age 73, federal income tax law[1] requires that individual to begin taking a series of annual distributions from the IRA known as Required Minimum Distributions, or RMDs.[2]

For a typical IRA owner, where the traditional IRA was originally funded with deductible contributions, 100% of the RMD is included in the individual's taxable income in the year the funds are distributed.

If the IRA owner also wants to make a charitable contribution, he or she can make the donation, and then deduct the charitable gift as an itemized deduction on Schedule A of Form 1040. Depending on the individual's personal tax situation, the deduction on Schedule A may, or may not, completely offset the additional income tax from the RMD.

Qualified Charitable Distributions

Federal income tax law contains a provision which allows certain IRA owners to take a distribution from their IRA, transfer those funds to qualifying charities, have the distribution count towards their annual RMD, and have the distribution *excluded* from taxable income. However, *no charitable deduction is allowed* for such a contribution. These distributions are called "Qualified Charitable Distributions," or QCDs.

Requirements for a Qualified Charitable Distribution

There are a number of requirements that must be met in order for a distribution to be qualify as a QCD. Among these are:

- **Type of IRA:** QCDs may only be made from a traditional IRA, a Roth IRA, or a "deemed" IRA under an employer qualified plan. Qualified charitable distributions may not be made from either a SEP IRA or a SIMPLE IRA.

[1] The discussion here concerns federal income tax law; state or local tax law may differ.

[2] Under the SECURE 2.0 Act of 2022, the age to begin RMDs increases to (1) age 73 for those who turn 72 after 2022 and 73 before 2033; and (2) to age 75 for those who turn 74 after 2032. Previously, age 72 was the mandated age to begin RMDs. Unlike a traditional IRA, a Roth IRA has no distribution requirement during the lifetime of the account owner.

- **Age requirement:** The IRA owner must be at least age 70½ at the time the distribution is made.

- **Dollar limitation:** QCDs are limited to no more than $100,000 per year. For a married couple, each spouse may distribute up to $100,000 per year.

- **Qualifying charities:** QCDs may generally be made to most charitable organizations. However, federal tax law prohibits QCDs from being made to either supporting organizations or donor advised funds.

- **Direct transfer:** In order to qualify, charitable transfers must generally be made *directly* from the IRA trustee to the charitable organization. If an IRA owner receives a distribution from an IRA, and then separately writes a check to the charity, this does not qualify. In this case, the IRA owner will generally have received a taxable distribution and would be entitled to deduct the contribution.

- **Deductible and non-deductible contributions:** If an IRA owner has both deductible and non-deductible contributions in an IRA, only that portion of a distribution that comes from *deductible* contributions qualifies as a QCD.

  Example: a taxpayer has an IRA containing $20,000 of deductible contributions and earnings, and $5,000 of non-deductible contributions, a total of $25,000. If the taxpayer gifts the $25,000 to charity, only $20,000 will be considered a QCD. The other $5,000 is not included in income (it's already been taxed), but it may be deducted as an itemized deduction on Schedule A.

- **Inherited IRAs:** QCDs may be made from an inherited IRA as long as the beneficiary has reached the age of 70½ when the distribution is made.

Failure to Meet the Requirements

If a qualified charitable distribution fails to meet all federal requirements, the result is:

1. To the extent the distribution consists of deductible contributions (and earnings), it will be included in the IRA owner's taxable income, and;
2. Any charitable contribution will be subject to the rules regarding deducting charitable donations, including the percentage of adjusted gross income (AGI) limitations, in effect in the year of contribution.

Any tax reduction will come from the IRA owner deducting the contribution as an itemized deduction on Schedule A.

Benefits to Using a QCD

Although there is no charitable deduction for making a qualified charitable distribution, the fact that a QCD is not included in an IRA owner's taxable income, and thus keeps taxable income lower than it otherwise might be, can bring significant benefits:

- **Taxable social security benefits:** The taxable portion of an individual's Social Security payments (none, 50%, or 85%) is calculated based on his or her adjusted gross income (AGI).
- **Medicare Part B and Part D Premiums:** If a taxpayer's adjusted gross income is high enough, his or her Medicare Part B and/or Part D premiums could increase in future years.
- **Capital gains and qualified dividends:** The marginal income tax rate applicable to most capital gains and all qualified dividends varies, depending on an individual's taxable income. Additional income could cause these types of income to be taxed at higher rates.
- **Schedule A medical expense deduction:** Unreimbursed medical expenses in excess of 7.5% of AGI are deductible as an itemized deduction on Schedule A. A lower AGI could mean a higher medical expense deduction.
- **Larger charitable contributions:** Deductible charitable contributions are normally subject to certain percentage of AGI limitations. QCDs are not subject to these limits, which could result in a larger contribution to a favored charity.
- **Tax credits:** A number of tax credits (a dollar-for-dollar benefit against the tax due) are phased-out when a taxpayer's AGI exceeds specified limits.
- **State taxes:** A number of states use the AGI figure from a taxpayer's federal income tax return as a part of the state tax calculation. A lower federal AGI may help reduce any state income tax liability.

SECURE Act Impact on Qualified Charitable Distributions (QCDs)

One provision of the SECURE Act, for tax years beginning after December 31, 2019, repealed the prohibition on an individual making a contribution to a traditional IRA after reaching age 70½. This change allows an individual to make a contribution to a traditional IRA at any age, assuming that he or she has "compensation" and meets other requirements. The act also introduced a provision that if an individual makes a *deductible* contribution to a traditional IRA after age 70½, and also takes a QCD, the amount of income excluded because of the QCD may be *reduced*, to reflect the deduction allowed for contributing to the traditional IRA.

SECURE 2.0 Act of 2022 Changes to Qualified Charitable Distributions

The SECURE 2.0 Act of 2022 made several changes to the law concerning QCDs:

- **One-time charitable distribution to a split-interest entity:** The Act provides for a one-time charitable distribution of up to $50,000 to a charitable gift annuity (CGA), a charitable remainder unitrust (CRUT), or a charitable remainder annuity trust (CRAT). The CGA, CRUT, or CRAT must benefit only the donor, his or her spouse, or both. The Act also requires that the annuity or trust be funded *only* with qualified charitable distributions, and that any CGA must begin fixed payments of at least 5.0% no later than one year from the date the funds were distributed. This new provision is effective for tax years beginning after December 29, 2022, and is in addition to the annual $100,000 qualified charitable distribution discussed earlier.

- **Taxation of income received:** As the law is written, the income derived from a CGA, a CRUT, or a CRUT funded with a qualified charitable distribution will be 100% taxable as ordinary income. This is true regardless of whether the QCD is made from an IRA funded with pre-tax contributions, or from a Roth IRA funded with after-tax contributions.

- **Inflation adjustments:** The SECURE 2.0 Act of 2022 also provides that both the $50,000 and $100,000 amounts are to be adjusted for inflation beginning in 2024.

Qualified Charitable Distributions from Roth IRAs

Although federal law allows QCDs to be made from Roth IRAs, there is generally little benefit to making a QCD from a Roth. First, Roth IRAs have no minimum distribution requirement during the account owner's lifetime. Second, a "qualified" distribution from a Roth IRA (one made after five years and meeting certain other requirements) is excluded from taxable income. Thus, by statute, a Roth IRA already provides two key benefits of a QCD.

A Roth IRA owner who wishes to make a charitable contribution is generally better advised to simply ignore the QCD provision. Assuming that distributions from the account are "qualified," a Roth owner can generally take a distribution from the account, not include the distribution in taxable income, make a charitable gift, and then deduct the charitable donation as an itemized deduction on Schedule A.

Seek Professional Guidance

As with many tax questions, a decision to make a qualified charitable distribution is best done after "crunching the numbers" to estimate, in advance, the effect of such a choice on an individual's tax situation. In this effort, the advice and guidance of trained, experienced tax and financial professionals is strongly recommended.

Disclosure Notice

The information that follows is intended to serve as a basis for further discussion with your financial, legal, tax and/or accounting advisors. It is not a substitute for competent advice from these advisors. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney. The application of other concepts may require the guidance of a tax or accounting advisor. The company or companies listed below are not authorized to practice law or to provide legal, tax, or accounting advice.

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