

# Advisor's Quarterly Update

## The Qualified Charitable Distribution – Tax Savings for Non-itemizers

The traditional IRA, long favored to accumulate assets for retirement, has now become the charitable giving vehicle of choice to make tax-free lifetime gifts without the need to itemize charitable deductions. The Tax Cuts and Jobs Act law eliminated most itemized deductions while doubling the standard deduction, thereby reducing the number of taxpayers who will itemize their deductions. A charitable gift provides no tax benefit for non-itemizers.

Older clients who no longer itemize and live in rental housing or who have paid off mortgages, having few or no deductions, will now use the standard deduction. With trillions of dollars in IRA accounts, the Qualified Charitable Distribution (QCD), referred to by the charitable sector as the “IRA charitable rollover,” is a way both non-itemizing clients and charities can win. A QCD can even help itemizers. However, it’s important to follow the rules.

### Requirements for QCD gifts

The Qualified Charitable Distribution, authorized by IRC Sec 408(d)(8), was made permanent by Congress at the end of 2015. The rules governing QCDs are:

- Donor must be 70 ½ or older at the time of the gift. Donors can start making gifts in the year they turn 70 ½ and must make the gift after the 70 ½ birthday.
- The gift must come from a traditional IRA, Roth IRA, and inactive SEPs and Simple IRAs.
- The IRA administrator must make distributions directly from the IRA account to the Red Cross.
- The total QCD in any year is capped at \$100,000 per taxpayer.
- The contribution must be made to a public charity.

### Restrictions for QCD gifts

There are restrictions for the gift from an IRA account to qualify as a QCD.

- The donor is not permitted to take an income tax charitable deduction for a QCD. IRC Sec 408(d)(8)(E).
- The QCD cannot be made to a donor advised fund, supporting organization, or a private foundation. IRC Sec 408(d)(8)(B)(i).
- A QCD is permissible only if a deduction for the entire distribution would be allowable. A QCD can’t be used for gala tickets, to purchase items at charity

auctions, or other situations where the contribution is only partially deductible. IRC Sec 408(d)(8)(C).

- Likewise, it is impermissible to fund life income gifts such as charitable gift annuities, charitable remainder trusts, or pooled income funds with a QCD.

### **Tax benefits for QCD gifts**

There are various tax benefits for qualifying QCD gifts.

- For clients who do not itemize deductions, the QCD is a tax-free gift to the Red Cross. It has the same tax-effect as if a client withdrew funds from an IRA account and used the funds to make a charitable contribution which she then deducted on her income tax return. The QCD gift is not included in the client's reportable taxable income.
- The QCD counts toward the client's required minimum distribution (RMD). For clients who do not need their RMD, this is a tax-efficient way to use the RMD to make charitable contributions. IRS Notice 2007-7, 2007-5 IRB 395, Q & A-42.
- The 60% of adjusted gross income (AGI) limitation for deducting cash gifts to charity in any one tax year does not apply to the QCD. A donor can make a tax-free QCD gift exceeding the AGI limitations.
- The donor may avoid having a portion of Social Security benefits taxed by making a QCD, because the QCD gift is not counted in reportable taxable income. Social Security benefits are taxed depending on the income of the taxpayer.
- Since premiums for Medicare Part B and prescription drug coverage are tied to income, a QCD gift that reduces reportable taxable income may enable the donor to pay a lower Medicare premium.

### **Non-IRA retirement accounts**

- Non-IRA accounts such as 401(k), 403(b), and 457(b), and *active* SEP-IRA or SIMPLE-IRA accounts do not qualify for QCD gifts. However, there is an exception for *inactive* SEP-IRA and SIMPLE-IRA accounts where the employee has retired, and the employer is no longer making contributions to the plan.
- It is permissible to rollover qualified plan retirement accounts into a traditional IRA account that will qualify for QCD gifts. IRS rules for such rollovers should be consulted if the account owner wants to make QCD gifts from a rollover account and have the QCD gift count toward their required minimum distribution.

### **QCD Substantiation**

- Even though no charitable deduction is permitted for QCD gifts, a contemporaneous written acknowledgment under Sec. 170(f)(8) must be provided to the donor by the charity.
- The acknowledgment should contain the date of the gift, the amount of the gift, that the gift was received directly from the IRA plan administrator, and that the gift is intended to be a Qualified Charitable Distribution under Sec. 408(d)(8) of the Internal Revenue Code. The acknowledgment should state that the charity receiving the gift is eligible to receive tax deductible contributions and that the gift was not made to a donor advised fund or a supporting organization. The acknowledgment should also state that no goods or services were received in exchange for the gift.

### **QCD Tax Reporting**

- The IRA custodian will send the account owner/donor a 1099-R listing all distributions whether a QCD or direct withdrawal from the IRA account. The donor will enter the total distributions on Line 15a.
- The donor will list only the *taxable* distributions on Line 15b. If only part of the IRA distribution is a QCD, the donor should enter the amount that is *not* a QCD on Line 15b and enter “QCD” next to line 15b.
- If the entire distribution is a qualifying QCD and meets the entire RMD requirement, the donor should enter “0” on line 15b.

### **QCD information of interest**

- The QCD can be used to satisfy a legally binding pledge. Notice 2007-7, 2007-5 IRB 395, Q & A-44.
- It is permissible for the IRA custodian to make a check payable to the Red Cross and mail it to the IRA account owner, who can then forward or deliver the check to the charity. Notice 2007-7, 2007-5 IRB 395, Q & A-41.
- Many IRA custodians have their own forms for account owners to request a QCD. If the IRA custodian does not have such a form, many charities have template letters that can be submitted to the IRA custodian requesting a QCD gift be made to the charity.
- Spouses can each make QCDs from their respective traditional IRA or Roth IRA accounts, up to \$100,000 per year per spouse.
- QCD gifts can be made to any number of qualifying charities in a tax year and in any amount, provided the total QCD gifts in any tax year do not exceed \$100,000.

Many fewer taxpayers will be eligible to itemize deductions due to the provisions of the Tax Cuts and Jobs Act. The IRA Charitable Rollover, or Qualified Charitable Distribution, will likely grow in popularity. Knowing the rules and pitfalls of QCD gifts can assist clients in fulfilling their philanthropic goals in a tax-efficient manner.