PERSONAL FINANCE

A Guide to Qualified Charitable Distributions

Who can do these beneficial transfers, with how much money, to what kinds of charities--and how to execute (and report) the QCD.

Natalie Choate
Nov 11, 2016

Some IRA owners can legally transfer money directly from their IRAs to charity, either in fulfillment of their required minimum distribution (RMD) or otherwise. Investors need to know who can do this with how much money, which kinds of charities qualify, how to do (and how to report) the transfers, and the benefits of this type of transfer.

Which retirement plans: Qualified charitable distributions (QCDs) may be made from traditional IRAs, other than SEP-IRAs and SIMPLE plans that are actively receiving employer contributions. QCDs can theoretically be made from Roth IRAs, but the requirement that the distribution must come from funds that otherwise would be included in the IRA owner's gross income (if distributed to him or her) precludes most Roth IRAs. QCDs may not be made from 403(b) or 401(k) plans or any other type of retirement plan other than IRAs.

Who: Only individuals who are over age 70 1/2 may make QCDs. The test is based on the actual age-70 1/2 "birthday." Donald Trump's 70th birthday was June 14, 2016. He can make charitable transfers from his IRA on or after Dec. 14, 2016--but not before. A beneficiary older than 70 1/2 can make a QCD from an inherited IRA.

Which charities: The transfer must be made directly to a qualifying charity. Any public operating charity will qualify, but the following can *not* be recipients of QCDs: Donor-advised funds, split-interest charitable trusts (such as charitable remainder trusts), and supporting organizations.

How much: A QCD can be for any amount, subject to the annual limit of $100,000 per IRA owner per year. So, an over-age-70-1/2 IRA owner can make QCDs of $1, $10, $100, or any amount she chooses, to as many or as few charities as she wants, up to the annual dollar limit.

The donor can make these transfers from multiple IRAs in the same year, subject to the overall dollar limit of $100,000.

A husband and wife can each make QCDs from their respective IRAs, if both are over age 70 1/2. But spouses cannot use each other's dollar limits; for example, a wife cannot use husband's dollar limit to give $200,000 from her IRA.

Subject to the $100,000 limit, and possibly fees or limits imposed by the IRA provider (I haven't heard of any such limits to date), the IRA owner can make as many QCDs as he wants, whenever he wants to make them, during the year. Because of the paperwork involved, it would be smart not to wait until the very end of the year, however.

MORE ON THIS TOPIC
- Tax Reporting for Your IRA

QCDs and RMDs: A QCD counts toward the required minimum distribution for the year it is made, to the extent the RMD has not previously been distributed. For example, if Dave's IRA RMD for 2016 is $15,000, he can satisfy that by making $15,000-worth of QCDs. If he has already taken his RMD for the year, he can still make a QCD (up to the full $100,000 if he wants to)--it just won't count as his RMD because he already took that.

Unfortunately, the QCD works to satisfy the RMD only with respect to IRAs, since QCDs cannot be made from other types of retirement plans.

Other QCD tax rules: The charitable gift from the IRA must be of the type that would be 100% tax deductible as a charitable contribution if made from outside funds (without regard to the limits on charitable giving as a percentage of gross income). So, you cannot make a QCD contribution in exchange for a "charitable gift annuity," for example. There cannot be any consideration or other thing of value given back to the IRA owner--the charity must get 100% of the value of the gift immediately!

One more weird little rule: The QCD is deemed to come entirely out of the pretax money in the IRA, rather than proportionately out of the pre- and aftertax money in the donor's IRAs (which is the treatment of most other IRA distributions).

Tax treatment and benefit: The QCD is not included in the IRA owner's gross income. Thus, the distribution does not increase gross income for purposes of determining such things as whether the IRA owner is subject to the extra 3.8% tax on investment and compensation income, taxability of the IRA owner's Social Security benefits, whether the IRA owner will suffer reduction of itemized deductions or of personal exemption, and the IRA owner's Medicare Part B premiums. All of those financial/tax impositions are based on the individual's "adjusted gross income," not his "taxable income."

Of course, the IRA owner also does not get a charitable deduction for the QCD. But since charitable contributions give rise only to an itemized deduction (reducing *taxable* income), and do not reduce *adjusted gross* income, an IRA distribution to the owner (includible in gross income) matched with a charitable contribution deduction is not as favorable as simply excluding the IRA distribution from gross income in the first place with a QCD.

Most advisors agree that the QCD is a favorable way to handle RMDs for the charitably inclined client--after all, the alternative is a taxable required minimum distribution. Is the QCD an advantageous way to make charitable gifts above and beyond the RMD amount? That depends on the individual's other options for charitable giving. Such alternatives as donation of appreciated stock should be compared with the QCD.

Mechanics and tax reporting: The IRA owner sends instructions to the IRA provider indicating what checks to issue to which charities. The IRA provider then (usually) gives the checks to the IRA owner to transmit to the charities. The IRA owner must then obtain from the charities receipts for these gifts just the same as with any charitable gifts he makes outside the IRA.

The IRA provider will report these as distributions to the owner from the IRA. The Form 1099-R it files with the IRS will have no mention of "QCDs" and no hint that the distributions are not taxable! It is up to the IRA owner on his personal tax return (Form 1040) to report the gross distribution and report the taxable portion as zero, writing "QCD" in the margin next to line 15b.

Where to read more: QCDs are authorized by IRC § 408(d)(8). Enacted on a temporary basis each year from 2006 through 2014, § 408(d)(8) was made a permanent part of the Code for 2015 and later years by the Protecting Americans from Tax Hikes Act of 2015 (P.L. 114-113). See also IRS Notice 2007-7 (Part IX), 2007-5 I.R.B. 395, Q & A 34 through 44, and IRS Instructions for Forms 1099-R and 5498 (2016), p. 1, and Form 1040 (2015), p. 25 ("Exception 3").

Now available in electronic edition! *By popular demand, Natalie Choate's book Life and Death Planning for Retirement Benefits has been published in an electronic version. The e-book edition gives you the entire book in word-searchable format, PLUS two additional chapters (on life insurance and annuities in retirement plans) that were left out of the print edition for reasons of space. Live links to cross-referenced book sections and most cited tax sources. Access anywhere you have an internet connection. Visit http://www.retirementbenefitsplanning.com to subscribe or learn more.*

MORE ON THIS TOPIC
- Tax Reporting for Your IRA
- 12 No-Tax and Low-Tax Retirement Plan Distributions