Qualified Charitable Distributions Maximize Your Giving with Minimum Tax Exposure

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Prelude: Required Minimum Distributions (RMDs)

To understand Qualified Charitable Distributions (QCDs), we first discuss Required Minimum Distributions (RMDs). (This brief discussion of RMDs touches only the essentials that are relevant to QCDs. See our or the IRS' other publications for more detailed discussion of RMDs.)

If you hold assets in an Individual Retirement Account (IRA) and have reached age 72 (After 2019, Before that the trigger age was 70 ½) you must distribute at least the Required Minimum Distribution from your IRA each year[1] – whether you want or need the money or not.[2] The amount of the RMD is determined by reference to one of several actuarial tables the IRS publishes, and the asset balance in your account at the beginning of each year.

Failure to distribute at least the RMD from your account subjects you to an "Excess Accumulation Penalty" – 50% of the missed or under-distributed amount.[3] And yes, your financial institution will rat you out. Bottom line: Skipping an RMD is really not a good plan.[4]

Making the RMD also costs you (unless you follow the guidelines in this discussion). The RMD is included in your taxable income (after adjustment for your basis in the account) and taxed at your highest marginal tax rate. It affects your eligibility for tax benefits that are tied to

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[1] IRC §408 and Treas. Regs. §1.408-8

[2] RMDs are not required in 2020. The CARES Act suspends the RMD requirement for 2020. RMD Relief applies to all of the plans that usually require RMDs:

- traditional IRAs
- SEP IRAs
- SIMPLE IRAs
- 401(k) plans
- 403(b) plans
- 457(b) plans
- profit sharing plans
- other defined contribution plans

Note: The Qualified Charitable Distribution rule applies only to traditional IRAs, inherited IRAs, and inactive SEP or SIMPLE IRAs. Inactive SEPs or SIMPLR IRAs are accounts that no longer receive employer contributions – either because you let the employment, or the employer discontinued the plan. We have seen several mentions of doing this transaction from a ROTH IRA – which, while feasible, makes no sense whatsoever to us since ROTH distributions face no RMD requirement, are unlimited, and tax free to begin with.

When CARES was enacted, the stock market was wallowing in a deep trough (having dropped nearly 35% in 31 days). RMD Relief allowed plan beneficiaries to avoid liquidating positions that were deep in the red – thus reducing depletion of the retirement account and allowing time for the market to recover. The market has since, rallied impressively – returning to 90-100% of its pre-coronavirus high water mark. Though the recovery obviates the original purpose of the suspension, the suspension remains in effect.

[3] IRC §4974, Treas. Reg. §1.401(a)(9)-5, Q&A-8, Treas. Reg. §54.4974-1

[4] IRS frequently abates this penalty if you show substantial cause. Nevertheless, who needs the hassle?

your Adjusted Gross Income. It may also push you over the threshold where tax disadvantages begin to appear.[5]

A Required Minimum Distribution that you neither want nor need is expensive any way you take it… Except

Qualified Charitable Distributions (QCDs)

If you are (or would like to become) charitably inclined; consider making a "Qualified Charitable Distribution" from your IRA directly to a qualifying charity. A QCD fulfills your Minimum Required Distribution obligation – but does not 1) force you to itemize the contribution, and 2) require you to include the distribution in your taxable income. Thus,

- The contribution becomes more "tax efficient" than if you itemized,
- You avoid being taxed or pushed into higher marginal tax brackets,
- You prevent phaseouts of tax advantages, and
- You don't trigger AGI related tax disadvantages.[6]

For its part, the charity probably receives a bigger contribution than they might otherwise get.[7]

There are some rules you should be aware of:

- ***One absolute hard and fast rule:*** You may not take possession of any distribution that you want to call a QCD. You can write a check directly from the IRA to the charity (if you have check writing on the account) or your financial institution may transfer monies by check or electronically. If the funds pass through any of your non-exempt accounts, you lose the election. (e.g. you write a check to yourself, deposit it in your checking account, but later decide it should be a QCD)
- ***And one more:*** Donors cannot receive any form of quid-pro-quo in exchange for a QCD – even if the donation is of a size or character that would normally qualify for the organization's "thank you" program.
- You may elect to treat up to $100,000 of IRA distributions as Qualified Charitable Distributions.
- Your Spouse may also elect to treat up to $100,000 of their distributions as Qualified Charitable Distributions.
- The $100,000 per person limit applies to the sum of all QCDs taken from all IRAs in a year. You may make one large contribution or several smaller contributions during the calendar year. QCDs can be made from one or any more than one IRA.

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[5] E.g. if the RMD causes you to exceed the Social Security income threshold, thus subjecting more of your Social Security income to taxation.

[6] There are, of course, exceptions – Aren't there always? Talk to your tax professional to see if the exceptions apply to you.

[7] QCDs radically lower the after-tax adjusted cost of a contribution of $X. "Rational Contributors" would thus be incentivized to give bigger contributions – or so goes the theory. We have not seen any credible research that addresses this.

- This year's QCD offsets only your current year RMD obligation. If the QCD exceeds the RMD, you don't get a carry-forward. You still have an RMD obligation for next year unless this year's QCD exhausts the funds in your IRAs.[8]
- The QCD does not use up any of your 60% of AGI limit for itemized charitable contributions. You are free to increase your charitable giving to use up that limit as well.
- You may support as many charities as you like using your QCD, as long as the total dollar amount does not exceed $100,000. However, the charities you choose must be 501(c)(3) organizations eligible to receive charitable contributions (churches and publicly supported organizations).[9]

Should You do This?

Qualified Charitable Distributions make sense if you:

- Have identified charities you want to support immediately with a substantial gift, AND none of those charities are private foundations, supporting organizations, or donor-advised funds.
- Want to make a larger charitable gift than you could if you donate cash or other assets. The AGI-based contribution limit does not apply to QCDs, allowing you to make larger gifts.
- Are required to take a minimum distribution from an IRA, but don't need the funds and you face increased tax liabilities if you take the distribution.
- Want to reduce the balance in an IRA to lower future required minimum distributions,

Mechanics of the Transaction

The mechanics of making a QCD are straightforward:

1. Choose one or more charities to receive the funds.
2. Vet the charities to make sure they are qualified to receive charitable contributions[10]
3. Review the charity's finances and operations to verify what they do, how they are likely to use the money you give them, and that you still want to fund them.[11]

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[8] Note the difference between this and the front-loading allowed for Donor Advised Funds and the cary-over allowed when charitable contributions exceed the itemized deduction 60% of AGI limitation.

[9] Private Foundations (particularly your own), Supporting Organizations, and Donor Advised Funds do not qualify. We strongly advise that you vet your charities before you donate.

[10] Use IRS's Charity Search Tool for public charities (https://www.irs.gov/charities-non-profits/tax-exempt-organization-search) Note: Churches and religious organizations are not required to register and may not appear on the IRS list.

[11] Guidestar maintains an extensive (not necessarily exhaustive) archive of organizations' operational documents and information reports (IRS Form 990). They also have a formal rating system – though we usually find it is better to do your own evaluation using theirs as pro-forma. If your chosen charity does business in only one state, the state probably has an archive as well – usually associated with the Secretary of State's Office. In CA for example the Registry of Charitable Trusts archives annual financial reports and changes to organizations' governing documents or mission. http://rct.doj.ca.gov/Verification/Web/Search.aspx?facility=Y Many tax-financial advisors also maintain

4. Contact each of the charities to determine their procedural requirements – e.g. how they are set up to receive direct ACH transfers to their accounts. While you are there, extract identifying information in case you need it later.
5. Inform your financial institution of your intention to make a QCD and give them the charity information you have gathered. Make sure they are equipped to make the transfers!
6. Tell your financial institution to execute your plan. (Moneys must be transferred on or before December 31 to fulfill the RMD requirement and to complete the charitable transaction…
7. Document the transactions Each charity should provide a "Contemporary Written Acknowledgement" (CWA) for donations that exceed $250. Hang on to it and give it to your tax professional. Your financial institution should also provide confirmation that the transaction was carried out within the rules.
8. Report the transaction as detailed below when you file your returns.

The first three steps are "optional" but highly recommended.[12] The final two steps are absolutely critical! Without the CWA you will lose the deduction if the Service challenges it.

Reporting the Contribution

Your financial institution should report charitable contributions on your form 1099-R

To report a qualified charitable distribution on your Form 1040 tax return,

- Report the full amount of the charitable distribution on the line for IRA distributions.
- Enter zero on the line for the taxable amount if the full amount of the distribution was a qualified charitable distribution[13]
- Enter "QCD" next to this line.

File Form 8606, Nondeductible IRAs, if you made the qualified charitable distribution from a traditional IRA in which you had basis and received a distribution other than the qualified charitable distribution from the IRA during the same year.

SOPs that facilitate charity analysis – Steven Roy Management will publish theirs when we get time – or ask for it.

[12] Some people LIKE to live dangerously and court disappointment.

[13] If the distribution is larger than the QCD enter the amount by which the distribution exceeds your QCD