## IRAs

# Helping IRA Owners Understand and Make a Qualified Charitable Distribution

**Questions & Answers** 

#### **Purpose**

The purpose of this brochure is to explain the federal laws applying when a person makes a special distribution/contribution called a QCD (Qualified Charitable Distribution). If you have funds in a traditional IRA or an inactive SEP-IRA or SIMPLE IRA and you are age  $70^{1/2}$  or older, you may by making a QCD.

#### What tax benefit will I receive by making a QCD?

You are able to pay no income taxes when you instruct your IRA funds be withdrawn and be given to your favority charity, including your church or alma mater.

You receive this benefit even if you use the standard deduction and are unable to claim a tax deduction for your charitable contributions.

In addition, the IRS has issued guidance that you may use your QCD to also satisfy your RMD for the current year.

#### What is the basic benefit of making a QCD?

In general, a person age  $70\frac{1}{2}$  or older will able to direct his or her IRA custodian to withdraw an amount of up to \$100,000 from his or her IRA and have such proceeds issued directly to a qualifying charitable organization. The distribution will be tax free if certain rules are met.

# Can you give an example of the tax benefit I receive by making a tax-free charitable distribution for 2021?

Yes, Let's assume that you normally give your church \$900 each year. Your required distribution is \$800. If you instruct your IRA custodian to withdraw \$900 from your IRA and directly pay it to your church, then you will not be taxed on this distribution and you will have satisfied your RMD.

## What requirements must I meet in order to take advantage of this charitable contribution law?

- 1. You must be age 701/2 or older.
- 2. You must have a traditional or Roth IRA.
- 3. Your charitable contribution must otherwise be deductible. A distribution qualifies to be a qualified charitable distribution only if a deduction for the entire distribution would be allowable to be deducted under Code section 170 (but you are able to disregard the percentage limits). Caution: You receive the tax-free charitable contribution treatment only if the entire amount would have qualified as a charitable deduction. Thus, if the contribution amount is reduced because of a benefit

received by you in exchange, or because the custodian does not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

- 4. The distribution, but for this rule, must otherwise have been required to be included in your gross income. The withdrawal of basis (i.e. nondeductible contributions) from a traditional IRA is not includable in income, and consequently, such withdrawal does not qualify as a tax-free charitable contribution. If the withdrawal from a Roth IRA will not be taxed because it is either the withdrawal of basis or because the distribution is a qualified distribution, such withdrawal does not qualify as a tax-free charitable contribution.
- 5. Payment, no matter in what form (electronic transfer, check, etc.), must be made directly from the IRA to the qualifying charitable organization. The instrument used for payment must not be negotiable by the IRA accountholder.

# Is there a limit on the amount which can be withdrawn and contributed to one or more charities each year?

Yes, you may contribute up to a maximum of \$100,000 each year.

#### May I make more than one QCD?

Yes, you may make a QCD to an unlimited number of charities or tax exempt organizations as long as you do not exceed the \$100,000 limit.

# Is my qualified charitable distribution amount reduced if I make a deductible contribution to my traditional IRA?

Yes. A new rule applies for 2020 and subsequent years. Effective for QCDs made in 2020 and subsequent years, the QCD exclusion amount for the current year must be reduced by an amount (but not below zero) equal to the excess of: the aggregate of all deductions allowed for all tax years on or after attaining age 70½ over the aggregate amount of the QCD reductions for all tax years preceding the current year. Some IRA owners used to excluding 100% of the distribution on their tax return as a QCD, will no longer be eligible to do so if they choose to make a deductible contribution.

#### May my spouse and I both make a QCD?

If you and your spouse have separate IRAs, you may each contribute the maximum of \$100,000 per year.

### If I have two or more IRAs, may I contribute \$100,000 from each one?

No, the maximum you can contribute per year is \$100,000. This maximum is "per person," NOT "per IRA."

#### Is there a deadline to make a QCD?

Yes, if you wish to make a QCD for the 2020 tax year, it must be made by December 31, 2020. The deadline for the 2021 tax year is December 31, 2021 and for any subsequent year by December 31st of such year.

## May I deduct my QCD on my Schedule A as a charitable contribution?

No.

#### Will I benefit by making a QCD from my Roth IRA?

Almost never. It will benefit you to use this rule, and you are eligible to use this new rule only if the distribution from your Roth IRA would be a nonqualified distribution and would be comprised of taxable income.

Once you are age 59<sup>1</sup>/<sub>2</sub> or older and you have met the 5 year requirement, any withdrawal from your Roth IRA will be qualified and cannot be used to make a QCD. A qualified Roth distribution cannot be used to make a qualified charitable distribution.

## What special tax rules might apply when I make a QCD?

In the case of a distribution of funds from a traditional IRA, the special pro rata taxation rule as set forth in Code section 72 for IRAs is not to be used. In the case of a nonqualified distribution from a Roth IRA, the standard ordering rules (annual contributions, conversion contributions, and then earnings) will not be used. Rather, the distribution is treated as consisting of income first, up to the aggregate amount that would be includable in gross income (but for this provision) if the aggregate balance of all IRAs were distributed during the same year. Proper adjustments in calculating the tax treatment of future distributions are to be made to reflect the fact that "taxable income" was transferred to the charity.

## What charities qualify in order for the IRA distribution to be tax free for the accountholder?

You and your tax adviser must make the determination that a charity is one which entitles you to treat the distribution as tax-free. The so-called 50-percent organizations, as defined in Code

section 170(b)(1)(A) will qualify. However, the supporting organizations described in Code section 509(a)(3) are excluded, as are donor advised funds. Publication 526, Charitable Contributions, lists the following organizations as being the most common:

- 1. Churches, synagogues, temples, mosques, and other religious organizations;
- 2. Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt);
- 3. Nonprofit schools and hospitals;
- 4. Public parks and recreation facilities;
- Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Clubs of America, etc.
- 6. War Veteran's groups.

## How do I indicate that I wish to make a qualifying tax-free charitable contribution?

If you are an individual who qualifies for this special tax benefit, you will want to contact your IRA custodian or trustee. Your IRA custodian will have the proper form to complete to indicate the amount of the distribution and the charity to which you want the funds sent. The funds will then be withdrawn from your IRA and will be paid directly to the qualifying charity of your choice. The payee on the IRA trustee's check must be the charity. The charity or the IRA custodian should furnish you or your IRA custodian with a receipt for your gift. IRS rules do permit you to furnish the check to the charity if you would wish to do so.

## Can the charitable distribution be made from a SEP-IRA or SIMPLE-IRA?

Distributions from SEP-IRAs or SIMPLE-IRAs are generally <u>ineligible</u> for this special treatment, as are distributions from qualified plans and other types of retirement plans. However, funds within a SEP-IRA or a SIMPLE-IRA are ineligible to be a QCD only if the SEP-IRA or the SIMPLE-IRA is "ongoing." The IRS has defined "ongoing" to mean there needs to be an employer contribution made for the plan year ending with or within the IRA owner's taxable year in which the charitable contributions would be made. If an employer has <u>not</u> made an annual contribution, then funds may be directly transferred from a SEP-IRA or SIMPLE-IRA as a QCD, assuming the other requirements have been met.

In addition, it would be possible to roll over funds from a SEP-IRA, SIMPLE-IRA (after the two-year holding period has been met), and other types of retirement plans to a traditional IRA and then make the charitable contribution from the traditional IRA.

# Can a beneficiary who has inherited an IRA make a qualified charitable distribution and use it to satisfy his or her RMD?

Yes, but the beneficiary must comply with all of the requirements, including being age  $70^{1/2}$  or older.

#### Is special IRS reporting required?

Your IRA custodian will prepare a Form 1099-R, as they would for any IRA distribution. That is, it will indicate you have taxable income equal to the amount of the QCD. You will be responsible to show on your Form 1040 or other tax form, why the distribution is not taxable.

The IRS instructions for reporting a qualified charitable distribution on Form 1040 state:

"If the distribution is a qualified charitable distribution (QCD), enter the total distribution on line 4a. If the total amount distributed is a QCD, enter -0- on line 4b. If only part of the distribution is a QCD, enter the part that is not a QCD on line 4b (unless another exception applies to that part of the distribution). Enter QCD next to line 4b."

## Has the age requirement for a QCD also changed to be age 72 which is now the RMD rule?

No, it is still age 70½. Although intertwined, these are separate rules.

# Should I discuss this subject with my legal or tax advisor to make sure I qualify for this tax-free tax treatment?

Yes. You are entitled to exclude the transferred amount from your taxable income only if numerous conditions are met.

The information provided in this brochure is not intended to be legal or tax advice. You should consult your attorney or tax advisor for information that relates to your specific circumstances.