Qualified Charitable Distributions

What's new after the SECURE Act?

By Thomas A. Gorczynski, EA, USTCP

A qualified charitable distribution (QCD) is a valuable tax reduction strategy, especially after the tax law changes made by the *Tax Cuts and Jobs Act*. However, the SECURE Act threw a wrench into the ability of some taxpayers to take full advantage of a QCD.

Tax professionals with clients over age 70½ should be aware of this provision and how to properly advise clients about it, because it could save thousands of dollars in tax over multiple years.

Overview

The QCD is a distribution made directly from a taxpayer's individual retirement account (IRA) to a charitable organization. A taxpayer will not receive a charitable contribution deduction on Schedule A for the QCD; however, the distribution receives more valuable tax benefits:

- The taxpayer excludes the QCD from income; therefore, the QCD amount increases neither adjusted gross income (AGI) nor taxable income.[1]
- The QCD amount counts toward the taxpayer's required minimum distribution (RMD) from their traditional IRAs.[2] Taxpayers can satisfy their entire RMD requirement with a QCD.

The maximum QCD an individual taxpayer can make is $100,000 per year; therefore, a married couple can have total QCDs of $200,000.[3] Taxpayers who have multiple IRA accounts can take QCDs from any of their IRAs provided they do not exceed the $100,000 aggregate limit over all IRAs.[4]

Example 1: John is 71 and must take a $6,000 RMD during the tax year. He makes a $10,000 direct transfer from his IRA to an environmental organization exempt from tax under §501(c)(3) for which he could take a charitable contribution deduction. John excludes the $10,000 from his income, thus having no effect on his AGI or taxable income, and the distribution also meets his RMD requirement. John takes no deduction on Schedule A for the distribution amount.

Requirements

For an IRA distribution to be a QCD, it must meet four criteria:

(1) The IRA custodian must directly transfer the funds from the IRA to a charitable organization.[5]

(2) The IRA distribution occurs after the IRA owner turns age 70½.[6]

(3) The IRA distribution would otherwise be fully taxable if not for the QCD provision.[7]

(4) The taxpayer would otherwise receive a charitable contribution deduction for the entire distribution amount.[8]

The QCD exclusion applies to distributions from any type of IRA, including a Roth IRA described in §408A and a deemed IRA described in §408(q), provided that it's neither an ongoing SEP IRA described in §408(k) nor an ongoing SIMPLE IRA described in §408(p). For this purpose, a SEP IRA or a SIMPLE IRA is ongoing if it is under an employer arrangement under which an employer makes a contribution for the plan year ending with or within the IRA owner's taxable year in which the taxpayer would make the charitable contribution.[9]

Beneficiaries of an inherited IRA can also make a QCD from the inherited IRA provided they are over age 70½ on the date of the distribution.[10] Inherited IRAs have RMD requirements independent of the taxpayer's directly owned IRAs, and funds withdrawn from an inherited IRA cannot satisfy a taxpayer's RMD requirement for his or her directly owned IRAs.

A charitable organization for QCD purposes is more limited. A taxpayer can only direct the QCD funds to organizations described in §170(b)(1)(A), which are the charitable organizations whose deductions are subject to the overall 60% of AGI limit (this is normally 50%, but TCJA increased it through tax year 2025). However, donations to supporting organizations described in §509(a)(3) or donor-advised funds described in §4966(d)(2) do not qualify.[11]

If the taxpayer receives the IRA funds, and then contributes the distribution amount to a qualifying charitable organization, it does not qualify as a QCD. In this case, the IRA distribution is income to the taxpayer, and the taxpayer would deduct the distribution as a charitable contribution on Schedule A. However, if a check from an IRA is payable to a charitable organization and delivered by the IRA owner to the charitable organization, then the payment is a direct payment and can meet the QCD requirements.[12]

Tax Planning Impacts

There are many ways in which a QCD can provide a tax-preferred outcome to a taxpayer compared to a normal IRA distribution followed by a charitable contribution.

Standard Deduction. If a taxpayer distributes funds from an IRA, donates the funds to a charitable organization, and has insufficient deductions to itemize on Schedule A, then the IRA distribution

increases both AGI and taxable income, and leads directly to more tax. Even if the taxpayer does itemize deductions and can fully deduct the charitable donation, the QCD is still optimal because it reduces AGI, which many other deductions, credits, and additional taxes use as a threshold.

Social Security. Taxpayers can pay tax on up to 85% of Social Security benefits based upon their modified AGI, starting at $25,000 for single taxpayers and $32,000 for married filing joint taxpayers.[13] Therefore, the use of a QCD to reduce AGI can reduce or eliminate the taxation of Social Security benefits.

RMD Requirement. Taxpayers who have an RMD requirement but don't need the IRA funds during the year can use the QCD strategy to completely avoid tax on the RMD amount and reduce both AGI and taxable income while meeting charitable donation goals.

Net Investment Income Tax. A taxpayer is subject to the 3.8% net investment income tax on investment income if AGI is over $200,000, or $250,000 on a married filing joint return.[14] Since the QCD prevents the IRA distribution amount from increasing AGI, taxpayers can reduce or eliminate their exposure to the net investment income tax on items such as interest and dividends.

SECURE Act Complications

Congress passed the SECURE Act in December 2019 in order to encourage taxpayers to increase retirement savings. Two provisions indirectly impacted QCDs, and one provision negatively impacts the ability of some taxpayers to make QCDs.

First, the SECURE Act delayed the RMD starting age from 70½ to 72 for taxpayers who turn 70½ after December 31, 2019.[15] However, Congress did not change the QCD starting age, so a taxpayer can continue to make QCDs once he or she turns age 70½ even without an RMD requirement.

Second, for IRA owners who die after December 31, 2019, their beneficiaries are no longer subject to annual RMD distributions; instead, the beneficiary must completely distribute the IRA account within 10 years.[16] Beneficiaries subject to this accelerated distribution rule who are over age 70½ can use the QCD to reduce or eliminate the tax consequences of the IRA distribution(s). There are five classes of IRA beneficiaries who can continue to use the old "stretch" rules and take RMDs from the inherited IRA, most notably surviving spouses.[17]

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Lastly, the SECURE Act allows individuals over age 70½ with earned income to make deductible traditional IRA contributions after December 31, 2019.[18] However, taxpayers who make a deductible IRA contribution after age 70½ must then recapture the deduction amount from a later QCD, making it partially or fully taxable.

Example 2: Sydney inherits an IRA with a balance of $35,000 at age 68. He must fully distribute the IRA within 10 years. Sydney typically donates approximately $5,000 per year to charitable organizations but does not itemize his deductions. Once Sydney turns age 70½, he can choose to make QCDs of $5,000 annually, or he can distribute the entire IRA as a QCD and bunch multiple years of planned charitable contributions.

Example 3: Ida makes a $5,000 deductible IRA contribution at age 71. At age 72, she makes a QCD distribution of $10,000 to her church. Because Ida made the $5,000 deductible IRA contribution, she must include $5,000 of the distribution in gross income, thus increasing both AGI and taxable income; the remaining $5,000 is a QCD excluded from gross income. Ida can take a $5,000 charitable contribution deduction on Schedule A for the amount she included in gross income if she itemizes deductions.

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Conclusion

The QCD is a powerful tax planning strategy for taxpayers over age 70½ because it allows for tax-free IRA distributions to meet both charitable giving goals and RMD requirements.

However, the SECURE Act created, in essence, a QCD penalty for taxpayers who take advantage of the new ability to make deductible IRA contributions after age 70½. The tax cost to individuals who utilize this new provision is not widely known.

Taxpayers who want to continue to contribute to IRAs during their 70s should consider a Roth IRA contribution instead, since that will not impact future QCDs. In addition, a taxpayer having Roth IRA assets in retirement increases distribution planning options since Roth IRA distributions are generally tax free. ■

Endnotes

1. §408(d)(8)(A)
2. IRS Notice 2007-7, Q&A 42
3. §408(d)(8)(A)
4. IRS Notice 2007-7, Q&A 34
5. §408(d)(8)(B)(i)
6. §408(d)(8)(B)(ii)
7. §408(d)(8)(B) flush language
8. §408(d)(8)(C)
9. IRS Notice 2007-7, Q&A 36
10. IRS Notice 2007-7, Q&A 37
11. §408(d)(8)(B)(i); Notice 2007-7, Q&A 35
12. IRS Notice 2007-07, Q&A 41
13. §86
14. §1411
15. §401(a)(9)(C)(i)(I) as amended
16. §401(a)(9)(H)
17. §401(a)(9)(E)(ii)
18. §291(d)(1) is repealed; §408(d)(8)(A) as amended

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