PG Calc

YOUR PARTNER IN PLANNED GIVING SUCCESS

Taking a Closer Look at QCDs

PG Calc Featured Article, October, 2020

By Edie Matulka, Senior Consultant, PG Calc

Qualified charitable distributions (QCDs), also known as charitable IRA rollovers, are particularly appealing to donors because they provide a tax benefit whether or not the donor itemizes deductions. While on the surface they seem simple – request a payment go directly from the plan administrator to a qualifying charity – there are nuances to these types of gifts of which charities should be aware. Let's take a closer look at some of those subtleties as they relate to QCD requirements.

Age at which one can make a QCD

The IRA account owner must be 70 ½ or older at the time of the QCD transfer. It is not enough if the IRA account owner turns 70 ½ in the year of the gift. The donor must have been 70 ½ or older *on the date of gift*.

A closer look: The age limit for a QCD remains unchanged, despite the increase (under the SECURE Act) of the age limit for Required Minimum Distributions (RMDs) from 70 ½ to 72 for IRA owners who turn 70½ in 2020 or later.

This change leaves an 18-month period during which fulfilling an RMD will not be an incentive for a donor to make a QCD. Nevertheless, for donors who take the standard deduction rather than itemize, using QCDs to make charitable gifts will remain the most tax-efficient way to make gifts once they reach 70½. Encouraging such gifts even absent an RMD highlights that the QCD is not tied to, nor limited by, the RMD amount or age requirements. For donors who opt not to make QCDs until they must take an RMD, the delay may result in larger IRA balances and thus larger RMDs, which may lead to larger QCDs once they start.

IRA Required Minimum Distributions

For donors who have reached age 72 and must take an RMD each year, one of the prime tax benefits of a QCD is that it counts toward the donor's RMD. Some individuals may not need the income from the RMD, but failure to take the RMD subjects them to a 50% penalty tax on the amount of the RMD not taken. Using a QCD allows a person to meet the RMD requirement while reducing the amount included in their gross income (or eliminating it if the QCD is for the entire amount of the RMD).

A closer look:
For an individual electing to make a QCD in full or partial satisfaction of their RMD, it is critically important that the QCD be completed within the intended year, so the donor doesn't face that 50% penalty tax. How the QCD is delivered can affect when the gift is considered complete.

The QCD must go directly from the IRA administrator to the charity. There are several ways that can happen. The IRA administrator can make a check payable to the charity and mail it directly to the charity. The IRA administrator can make a check payable to the charity and mail it to the account owner, who can then either forward the check to the charity or hand deliver it. And some IRA administrators have issued checkbooks to IRA account owners, allowing them to write checks on their IRA accounts. It is permissible for the account owner to write such a check payable to the charity and mail the check to the charity. That will meet the requirements for a QCD.

The mailbox rule is irrelevant for QCD gifts. The postmark date on the envelope is not the gift date insofar as the IRA administrator is concerned. The critical date is when the IRA administrator makes the distribution from the IRA account, as that is the date of transfer the administrator will report on Form 1099-R. If the administrator is issuing the check and sending it to the charity, in most cases the administrator removes the funds from the IRA account when issuing the check and that date is what will be reported on Form 1099-R.

A bigger issue as to gift date is when the donor has his own IRA checkbook and mails a check from that checkbook to the charity in late December. Even though a QCD check may arrive at the charity by December 31 it may not be considered a completed gift for the intended year. Charity staff may be on vacation for several weeks in December or the crush of year-end annual fund gifts could delay depositing the QCD check. If the charity doesn't deposit the check until January, the IRA administrator is not going to remove the funds from the IRA account until January. If the donor anticipated that the QCD was to count toward his RMD in the previous tax year, that is not going to happen. The donor may find himself subject to a 50% penalty tax on the amount of the RMD the donor failed to take.

Distribution directly to charity

The QCD must be made directly from the IRA administrator to the charity. It is permissible for the IRA administrator to issue a check payable to the charity and mail the check to the IRA account owner, for transmittal to the charity. A QCD from an IRA checkbook where the account owner writes a check to the charity and mails or delivers the check qualifies if all other IRS requirements have been met.

A closer look:

In the early days of QCDs, donors often looked to charities for suggested language for requesting such a distribution from their IRA administrator. However, once the QCD was made permanent most plan administrators created their own forms and/or procedures for executing a QCD. Some firms utilize forms specifically designed to request a QCD, while others have forms that combine the request for making a QCD on the same form used for making an RMD. Regardless of the form to be used, if not completed correctly the distribution may well be done in a way that causes it to fail as a QCD. In that case, the donor has made a taxable distribution from his IRA and this amount is eligible for an income tax charitable deduction. While the deduction may eliminate the tax on the distribution if the donor itemizes deductions, the doubling of the standard deduction has reduced the number of itemizers by about two-thirds.

Even if a donor itemizes her income tax charitable deductions, the increase in the donor's income may have other tax and financial implications. Avoid any temptation to help your donors complete the form or answer questions on the process – steer them to the plan administrator (as frustrating as that might be for them) or to their tax advisor. You do not want to be in a position where your guidance – whether correctly or incorrectly followed – resulted in an unintended distribution.

Income tax charitable deduction

The donor *cannot* take an income tax charitable deduction for a QCD gift. Instead, the distribution is excluded from the donor's taxable income – a much better result, particularly for donors who take the standard deduction rather than itemizing.

A closer look:

Anticipate that some donors will request an acknowledgment indicating that their QCD is fully deductible since it was contributed to a 501(c)(3) public charity. Don't do it. As already discussed earlier, a QCD donor is not eligible for a charitable deduction. Here's why:

Contributions to 401(k)s, 403(b)s, and other qualified retirement plans were excluded from the donor's taxable income at the time of contribution. Most of these qualified plans are rolled over into traditional IRAs. The transfer may occur when a donor changes employer or when the donor retires and is no longer eligible for the employer sponsored plan. Once again, the rollover to the traditional IRA is not subject to tax. In addition, qualified retirement plans and traditional IRAs do not pay tax on realized capital gain or on income from dividends and interest.

The "catch" is that beginning at age 59½ the plan owner can make withdrawals from the employer plan or IRA and those withdrawals are taxable at the plan owner's then applicable income tax rate. Then, beginning at age 72, the RMD requires annual minimum withdrawals from the qualified plan or IRA. These withdrawals are likewise subject to taxation as ordinary income. The IRA had the advantage of tax-free contributions and tax-free growth. There is finally a tax when funds are withdrawn from the IRA.

A QCD is a direct transfer from the plan administrator to your charity. The QCD is not distributed to the plan owner. Therefore, a QCD is a tax-free gift to charity. Taking an income tax charitable deduction would be "double dipping" since the donor never paid tax on the QCD assets in the first place.

Conclusion

The QCD is already a popular way for donors to make their charitable gifts. With fewer individuals now itemizing and the QCD now permanent, the number of QCD gifts should continue to grow given their tax-advantaged nature and ease of completion. However, gift officers should not lose sight of the nuances of the gift. Helping avoid unintended tax consequences leads to happy donors – which often leads to more gifts!