# Giving funds in IRAs to charity with QCDs

*A qualified charitable distribution is a direct transfer of traditional IRA funds to a qualified charity.*

- December 9, 2022 By Ed Slott

Funds held in individual retirement accounts are without question the best assets to give to charity. Since IRAs are loaded with taxes, why not help clients relieve that tax burden by using the IRA for charitable giving now?

Show clients who regularly give to charity how to use their IRA for those gifts. Most people who give to charity receive no tax benefits for their donations because they don't itemize deductions. Instead, they use the higher standard deduction, which offers no extra tax deduction for charitable giving.

Older taxpayers are even more likely to use the standard deduction since those aged 65 or older receive an extra standard deduction. For 2022, the standard deduction for a married couple filing jointly where each spouse is 65 or older is $28,700. [The regular standard deduction of $25,900 plus extra standard deduction of $1,400 for each spouse ($25,900 + $1,400 + $1,400 = $28,700.)]

Of course, there are exceptions for couples and individuals who have very large medical expenses or who make large charitable gifts. These outlays could make itemizing a better option, but that's not the case for most people.

This is where using IRAs for charitable giving can replace and even increase the otherwise lost tax benefits.

IRAs normally can't be given to charity or to anyone during the owner's life (except in divorce situations). The one exception is giving IRAs to charity by taking advantage of qualified charitable distributions.

**QCD TAX BENEFIT**

A QCD is a direct transfer of traditional IRA funds to a qualified charity. It's true that there's no itemized deduction for the gift. But with a QCD, the tax benefit is even better because the QCD is an exclusion from income, which reduces adjusted gross income. AGI is the most significant number on the tax return because it determines the availability of many tax deductions, credits and other benefits. Lowering AGI with a QCD could also reduce "stealth"-type taxes based on income, like the taxation of Social Security benefits or Medicare premium surcharges.

Even though the SECURE Act raised the required minimum distribution age to 72, the QCD age remained at 70½, so QCDs can be done even before RMDs begin. Doing early QCDs (before RMDs begin) can reduce IRA balances at a 0% tax rate and can lower future RMDs (since the IRA balance will likely be lower).

QCDs are limited to $100,000 per year, per person (not per IRA). They can also satisfy RMDs up to the $100,000 annual limit, but only if the timing is right. As year-end approaches, if clients want to do their giving via QCDs and have it offset part or all their 2022 RMD, the QCD must be done before the RMD is taken. If an RMD was already taken earlier this year, a QCD done after that will not erase that RMD income. Make sure clients are aware of this timing rule as they start thinking about gifting in December. If the RMD for 2022 was already taken, do the QCD early next year (before 2023 RMDs are taken) so it can offset 2023 RMD income.

**Example:**

Mary has a 2023 RMD of $5,000 and wants to give that amount to her church. If Mary does a $5,000 QCD in January 2023 (or at any time before taking her 2023 RMD), it will satisfy her $5,000 RMD. The RMD won't have to be taken and the distribution (the transfer to the charity) is excluded from income.

If instead, Mary takes her $5,000 RMD early in the year, and then does a $5,000 QCD, she will have to include the $5,000 RMD as income. The QCD will still be excluded from income, but the result is that a total of $10,000 will be distributed from Mary's IRA, and $5,000 of that is included in income.

### QCD LIMITATIONS

The only downside with QCDs is that they're not available to enough people. They're only available to IRA owners and IRA beneficiaries who are age 70½ or older. QCDs can only be made once you turn age 70½, not anytime in the year you turn age 70½. For example, if you will turn age 70½ tomorrow, then you don't qualify today.

QCDs aren't available from 401(k)s or other employer plans. QCDs also aren't allowed for gifts to donor-advised funds and private foundations, and they can't be made from active SEP or SIMPLE IRAs (where contributions are currently being made).

To qualify as a QCD more than $250, you must have what's known as a CWA, or contemporaneous written acknowledgment. A CWA is just a fancy name for the letter charities send to donors to state the value of the gift and the value of any goods or services received in return.

QCDs can't involve any quid pro quo. There can be no benefit back to the IRA owner for giving IRA funds to the charity, other than intangible religious or other similar titles or honors. The tax code states that to qualify as a QCD, the donation would have to be entirely tax-deductible if it were an itemized deduction. This is different from how itemized charitable deductions are treated. For itemized deductions, if the letter (the CWA) says that the gift was $1,000 but that $150 of that was received back in show tickets or dinners, then the net amount ($850) would still qualify as an itemized tax deduction. But for a QCD, any amount received back would disqualify the entire QCD. (However, even if a QCD is disqualified, the net gift could still qualify for an itemized charitable deduction for those who itemize.)

### QCD TAX TRAP!

The SECURE Act added another twist that could reduce or negate the QCD income exclusion benefit. That law allows traditional IRA contributions to be made after age 70½, but it couples that provision with a poison pill. If an IRA deduction is taken in the same year as a QCD is done (or in any year before the QCD), the QCD tax exclusion could be reduced or lost. Be sure to advise clients not to fall into this tax trap. Avoid the problem altogether by making Roth IRA contributions, instead of tax-deductible IRA contributions, after age 70½. Or, if income is too high to qualify for a Roth IRA contribution, do a “back-door” Roth IRA by contributing first to a nondeductible traditional IRA and then converting those funds to a Roth IRA.

While QCDs are subject to the $100,000 annual limit, any amount given beyond that limit can still qualify as an itemized deduction. A QCD can’t be taken both as an exclusion from tax and as an itemized deduction. But doing the QCD doesn’t mean that an itemized charitable deduction can’t be taken for other charitable gifts or for those over the $100,000 limit.

**OCDs VS. APPRECIATED STOCK**

Appreciated stock can also be gifted to a qualified charity and an itemized deduction can be taken for the fair market value of the stock if it was held for more than one year. There’s no tax on the appreciation as there would be if the stock was sold instead of gifted. In some cases where there are large gifts, this can produce a larger tax benefit than the QCD since QCDs are limited to $100,000 per year.

However, QCDs may still be the better option. The QCD is only available to those age 70½ or older, and life expectancy is shorter at that point. So, it might pay to hold on to that appreciated stock until death so that beneficiaries will receive a step-up in basis, eliminating the capital gain on the appreciation held during the life of the decedent. IRAs never receive a step-up in basis, so they make a better asset to give to charity.

By doing the QCD, the IRA balance is being reduced at a 0% tax rate. That leaves the IRA beneficiaries with a smaller IRA, and less tax to pay. Beneficiaries will end up with a larger share of non-IRA assets that they can receive income tax free with the step-up in basis.

Identify clients who might benefit from QCDs — before year-end and early next year. Many people make their charitable gifts in December. To qualify as a 2022 QCD, the funds must be transferred out of the IRA before year-end, so don’t cut it too close.