Morgan Stanley

Who Should Consider an IRA Charitable Distribution and How Does It Work?

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Summary

The Protecting Americans from Tax Hikes (PATH) Act of 2015 (among other things) made the Qualified Charitable Distribution (QCD) provision permanent. The Pension Protection Act of 2006 introduced the QCD provision for Traditional and Roth IRA owners (or beneficiaries after the death of the owner) who are age 70½ or older to make charitable contributions of up to $100,000 per year directly from their IRAs to an eligible organization without incurring any adverse federal income tax consequences. The distribution counts for the purpose of the Required Minimum Distribution (RMD) from IRAs, but is not included in calculating the individual taxpayer's limitation on charitable deductions in the year the donation was made.

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Q. Why might an IRA QCD be a better strategy than simply leaving my IRA to my heirs?

Q. Why is this a good strategy for substantial charitable donations?

Q. What types of retirement accounts can my donation come from?

Q. What are the key benefits of an IRA Charitable Distribution to a charity?

A. The IRA QCD provision can help to bolster your legacy while reducing your taxable estate. While you would not receive a charitable deduction for a transfer from your IRA to a charity, the amount of your transfer would not be included in your gross income, nor would it be subject to income tax. You would have the added satisfaction of knowing that your charity could receive the full amount, with no tax cost to you or to the charity.

Q. Is transferring money from an IRA to a charity right for me?

A. If you fit any of the following profiles, this may be a good strategy for you to review with your financial and tax advisors.

- You are 70½ or older and interested in using funds from your IRA to make a contribution to a charity.
- You expect to leave funds in your IRA to your heirs.
- You take the standard deduction when calculating your taxes.
- You are interested in donating more than half of your annual income to charity.
- You want to make a substantial gift to a charity for a particular purpose.

Q. Will I get the tax benefit even if I don't itemize deductions?

A. Many retirees take the standard deduction when calculating their income-tax liability because they don't generate enough deductible expenses or income to make itemizing worthwhile. As a result, they could be losing out on the tax advantages of deducting their charitable donations. Using the tax-free IRA QCD provision as a way to make charitable contributions would allow you to obtain the tax benefit of the contribution without having to itemize deductions.

Q. Why might an IRA QCD be a better strategy than simply leaving my IRA to my heirs?

A. IRA assets are subject to estate taxes and the IRA beneficiaries may have to pay income taxes on distributions from the IRA assets they inherit. Using the IRA QCD provision, you can reduce the size of your estate, thereby reducing the total amount of taxes imposed. You would effectively be giving your favorite charity the full gifted amount versus having a reduced net value for yourself or your named beneficiaries had you left the money within your estate.

Q. Does this strategy circumvent the cash limit on income I can give to a charity?

A. No, but it may raise that limit in some cases. Typically, an individual may only deduct a cash contribution to a charity up to 60%[1] of his or her adjusted gross income (AGI) in any given year (a lower AGI limit may apply to certain charitable contributions). Any excess charitable contribution deductions are carried over to the following five years. By using the IRA QCD provision, you can avoid the 60% AGI limitation and donate up to $100,000 from your IRA.

Q. Why is this a good strategy for substantial charitable donations?

A. The IRA QCD limit of $100,000 allows charitably-minded individuals, if they so wish, to fund ambitious programs such as underwriting a research project or sponsoring a scholarship program at their alma mater. The IRA QCD provision may be an ideal strategy that can allow you to make a substantial donation to fulfill your charitable goals in a tax-advantaged manner.

Q. Can I transfer funds from my IRA to another account and then write a check to charity?

A. No. Doing so would eliminate the tax-free treatment of the contribution and would cause the amount distributed from your IRA to be included in your taxable income. The IRA QCD must be paid directly from the IRA to the charity. For instance, if the IRA QCD is paid by check, the check must be issued by Morgan Stanley and payable to the charity (and not the IRA holder).

Q. How do I know what charities qualify?

A. Distributions directly to a qualified charity are only considered a QCD if they would otherwise qualify as a charitable deduction, other than meeting the percentage of income limits. However, according to the IRA QCD provision, payments to certain entities, such as donor advised funds and section 509(a)(3) supporting organizations, do not qualify for IRA QCD treatment, meaning the distribution will be treated as a typical IRA distribution and includable in your gross income for federal income tax purposes.

Q. Can the charity give me something of value in exchange for my donation?

A. You cannot receive anything of value in return for your donation. For example, you cannot get tickets to a charitable event for your donation.

Q. If I have made nondeductible contributions to my IRA, does that have an impact on this strategy?

A. Where individuals have made nondeductible contributions to their Traditional IRAs, a special rule treats transferred amounts as coming first from taxable funds, instead of proportionately from taxable and nontaxable funds, as would be the case with regular distributions. If you have made nondeductible contributions to your IRA, have your tax advisor determine how much of the donation is considered tax free under this provision.

Q. What paperwork needs to be submitted in conjunction with an IRA QCD?

A. IRA owners must complete an IRA Distribution form or a Letter of Authorization is permitted in certain situations.

Q. What types of retirement accounts can my donation come from?

A. Generally, all IRAs are eligible to make these direct payments to charities, except for ongoing SIMPLE and SEP (including SAR-SEP) IRAs. A SEP or SIMPLE IRA is considered ongoing if the employer made a contribution for the year in which the QCD would be made. Transfers to a charity from other retirement plans, such as a 401(k) or 403(b) plan, will not qualify under this provision. It may be possible, however, to roll over funds from these accounts into a Traditional or a Roth IRA and then make an eligible transfer to charity but before doing so, you should consult with your own independent legal and tax advisor.

[1] Under current law, the 60% AGI limit applies for tax years 2018 through 2025.

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