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QCD, DIRECT GIFT FROM AN IRA-TECHNICAL ANALYSIS

General

It's important to note that a distribution from retirement assets will generally be included in the taxable income to the donor; therefore, it's generally not a helpful technique unless the donor can make a "Qualified Charitable Distribution" (QCD). The ability to make a "QCD was first enacted as part of the Pension Protection Act of 2006 as a temporary law. It was picked up again under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and made permanent under the Protecting Americans from Tax Hikes Act of 2015. The Consolidated Appropriations Act of 2016 finally made permanent qualified charitable distributions (QCDs) from individual retirement accounts in year-end legislation.[1]

A QCD may be made from any type of IRA, other than a simplified employee pension under Sec. 408(k) or a SIMPLE retirement account under Sec. 408(p) in which the taxpayer is still active and receiving employer contributions.[2] Donors can make it from a Roth IRA (although Roth distributions generally are already tax-free and are not subject to RMDs), an inherited IRA, a rollover IRA, or a qualified employer plan that permits employees to make voluntary contributions to separate accounts or annuities (a "deemed IRA" under Sec. 408(q)).

In 2019 the SECURE Act increased the age for a taxpayer to begin taking RMDs from 70 1/2 to 72. This development only applies to taxpayers who reach 70 1/2 after 2019. If a taxpayer turns 70 1/2 in 2020 or later, you won't need to start taking RMDs until after attaining age 72. QCD's can still begin at age 70 1/2.

The donor may not make the QCD to a Sec. 509(a)(3) supporting organization (SO) or to a donor-advised fund (DAF) described in Sec. 4966(d)(2). Since the rollover is limited to organizations in Sec. 170(b)(1)(A), private foundations are also excluded, except for a private operating foundation.

Many charitable organizations and professional advisors hoped that Congress would extend the IRA Rollover to charitable remainder unitrusts, charitable remainder annuity trusts, pooled income funds, and charitable gift annuities. The IRA rollover currently does not include any of these options.

Suppose the transfer is not qualified because the IRA owner is less than age 70½. In that case, the transfer is to a supporting organization or a donor-advised fund, or a donor-benefit gift. The distribution is taxable to the owner under Sec. 408. However, the owner will qualify for a charitable deduction under Sec. 170 if the transfer is to a qualified charitable organization. With the 60% of AGI limit for charitable gifts of cash to public charities, it is possible that the gift may not be fully deductible in the year of the transfer. In that case, the excess may be carried forward for up to five years.

Tax Advantages of QCDs

A QCD allows a donor to direct transfers to a qualified charity of up to $100,000 of tax-deferred IRA assets. Funds that have already been distributed from the IRA to the IRA owner and donated to charity can't qualify. The reason is that taxpayers must include taxable IRA distributions in adjusted gross income. QCDs offer advantages over taking a taxable IRA distribution and then contributing the proceeds of that distribution to a charity. Take an IRA distribution causes the following:

- Income taxes on Social Security benefits may increase,
- (AGI) Limitations for charitable deductions can limit the current deduction of the charitable contribution of IRA distribution proceeds.
- Additionally, many donors over 70 1/2 will likely no longer itemize their deductions after January 2018 because of the Tax Cuts and Jobs Act of 2017.
- Medicare insurance premiums may increase.
- If a donor's state income tax law does not allow a charitable deduction but generally follows the federal definition of taxable income (e.g., Massachusetts), making a gift from an IRA is the equivalent of a state charitable income tax deduction. However, every state law needs to be confirmed.

Requirements

Only individuals who've attained age 70 ½ may make QCDs. For example, Isaac Williams, a violinist and conductor Isaac Williams reached age 70 ½ on Aug. 31 this year. A direct transfer from his IRA to the Chicago Philharmonic on or before Aug. 30 this year wouldn't apply to the QCD requirements. A charity receiving the QCD must provide the same contribution acknowledgment needed to claim a charitable income tax deduction. The charitable organization must qualify for an individual's charitable income tax deduction, but not a private foundation, a donor-advised fund, or a supporting organization under Internal Revenue Section 509(a)(3).

Making the Contribution

To contribute, contact the charity to determine the exact payee for the check. Then instruct the donor's IRA trustee or custodian to transfer directly to the charity from the IRA. Many trustees and custodians have forms and processes to make this transfer. It won't be eligible if the check is made to the donor. The charity must receive the payment directly from the IRA custodian or trustee and provide the donor with a contemporaneous written acknowledgment (the same as for an outright gift). The charity might want to go further and confirm that the contribution is not being added to a donor-advised fund or a supporting organization. Recent IRS guidance indicates that a check drawn on an IRA account and delivered by the donor/IRA owner to the charity will be considered a direct payment by the IRA trustee/custodian for these purposes.

Notice 2007-7 provides that a QCD is used to satisfy a donor's preexisting pledge without violating prohibited transaction rules.

More Than One IRA

Jack Williams has two IRAs: IRA Fidelity and IRA Schwab. Each IRA is worth $100,000. Each IRA holds $80,000 of pre-tax funds that will be taxable upon distribution and after-tax funds, or basis, of $20,000. Williams requests all of IRA Fidelity to be transferred to the Chicago Philharmonic.

Williams is treated as having made an $80,000 QCD from IRA Fidelity, plus a $20,000 QCD from IRA Schwab. After the contributions have been made, IRA Fidelity is closed. IRA Schwab still holds $100,000, but Williams's basis in that IRA is now $40,000 instead of $20,000. That saved Williams the trouble and risk of carefully contributing $80,000 from IRA Fidelity and contributing $20,000 from IRA Schwab.

A QCD can only include deferred taxable income from an IRA. Fortunately, the QCD rules provide that William's IRAs are aggregated to determine how much deferred taxable income is considered transferred to charity.[3]The amount of the transfer is deemed to consist of deferred taxable income, potentially from all IRAs. But, helpfully, there's an ordering rule. The QCD comes first from the contributing IRA (in this case, IRA Fidelity) than from any other IRAs (in this case, IRA Schwab). Only after the charitable transfer exceeds the sum of deferred income in both IRAs is there a transfer of funds having an income tax basis.

Cash vs. Property

Stocks held in an IRA can be transferred from an IRA to a charity. The value of the shares is treated as first carrying out deferred taxable income, up the value of the same stock. The IRA's basis in the stocks won't matter. Because the tax code always deems only deferred taxable income to have been distributed in a QCD, it won't matter whether money or other assets are transferred to charity so long as there's at least as much pre-tax value to cover the contribution.

Check writing from IRA and Satisfying QCD

Many donors direct a charitable IRA rollover via a written directive to the IRA plan administrator and direct charity distribution. However, some IRA account owners have check-writing privileges for their IRA and can write a check to a charity and is also considered a direct distribution from the IRA to the charity (and the donor will not be deemed as having dominion and control over the charitable IRA rollover assets). In 2007, the IRS provided guidance. IRS. Notice 2007-7 notes that a check from an IRA payable to a charity and delivered by the IRA owner to the charity will be considered a direct distribution from the IRA custodian. The check needs to clear the IRA account no later than December 31st to cover the year's required minimum distribution (RMD). This notice outlines it as an option: https://www.irs.gov/pub/irs-drop/n-07-07.pdf (see Q&A 41).

The QCD rules require action by the IRA administrator, which means the date of the gift is established when the IRA administrator transfers funds after the charity deposits the check. If a donor happens to mail an IRA check to a charity in late December and the charity doesn't cash it until early January, two problems will occur:

- The donor must declare her QCD on the following year's tax return.
- When a donor misses fulfilling all of her required minimum distribution for the year because of the delay, they will have to pay a 50% penalty tax on the under distribution.

Gift Planners must encourage donors to make their charitable IRA rollover gifts at least several weeks before the end of the year if they write their own checks, mainly if they rely on them to fulfill their required minimum distributions.

The Pitfalls of Donor Receiving Personal Benefits in Return for Gift

The entire exclusion amount will be disallowed when a donor receives any personal benefit from the recipient charity in connection with a QCD contribution. It's crucial that a QCD not be connected with a fundraising activity where goods, services, or other donor incentives are provided to donors at no charge, such as fundraising occasions that include meals, entertainment, etc.

A charity's written confirmation must generally include a statement that no goods or services were provided to the donor or a description and good faith estimate of the value of any goods or services provided in connection with the gift.[4]

Section 408(d)(8)(C) requires that the entire dollar amount of the QCD would have been deductible if it had been made from other assets. If any portion of the transfer is not deductible, the entire amount is disqualified. In rejecting similar treatment for a distribution from a DAF.[5] The IRS has taken the position that the fact that the deductible contribution gives donors access to a ticket you could not otherwise buy is itself a more than an incidental benefit.

Ongoing SEP-IRA Rollover

Charitable IRA rollovers are generally permitted for most IRAs. There is an exception for the SEP-IRA or a SIMPLE IRA. A charitable IRA rollover is not permitted if the employer has contributed to these accounts during the taxable year. However, if an employee has retired and the employer is no longer making contributions to the SEP-IRA, then it qualifies for the Sec. 408(d)(8)(A) IRA rollover.

Married Couple IRA Rollovers

The Charitable IRA rollover is limited to $100,000 per IRA owner each year. A married couple may transfer up to $100,000 from their personal IRA account to a qualified charity. If a married couple has substantial IRA accounts, up to $200,000 per year may qualify for IRA rollovers.

Inherited IRAs

After the IRA owner's death, a beneficiary of an inherited IRA who has attained age 70½ can make a

QCD.[6]

Summary

The prospect of making a direct distribution to charity without realizing the distribution as income is attractive to the following donors:

- Who does not need the added income and wish to avoid paying tax on their required minimum distribution
- Who will use the standard deduction rather than itemize (and so never benefit from a deduction for a charitable contribution)
- Households with adjusted gross income at or near the level at which itemized deductions are phased out (not applicable in times when Pease limitation is suspended)
- Donors who live in states that do not provide a general deduction for charitable gifts would otherwise be subject to the annual limit of 60% of adjusted gross income for deducting charitable gifts cash and 30% for a long-term gain property.

Finally, charitable organizations must avoid soliciting or accepting a charitable IRA rollover in connection with a fundraising effort if any personal benefit is provided to a donor. And charities must provide the required substantiation for IRA charitable rollovers in the same method as other cash gifts.

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[1] H. R. 2029, at Title I, Subtitle A, PART 1, Section 112, striking Internal Revenue Code Section 408(d)(8)(F)

[2] Sec. 408(d)(8)(B); see also Notice 2007-7, Q&A-36)

[3] IRC Section 408(d)(8)(d)

[4] See IRC Section 170(f)(8) or IRS Publication 1771

[5] Notice 2017-73, //www.irs.gov/pub/irs-drop/n-17-73.pdf

[6] Notice 2007-7, Q&A-37

“INSECURE”: A SOLUTION TO MAINTAIN LIFETIME PAYOUTS FROM AN IRA LEFT TO LOVED ONES

Introduction

The SECURE Act, which was signed into law on December 20, 2019, significantly changes the rules that apply to distributions from IRAs, 401(k)s, and similar accounts after the passing of a plan participant. The new law eliminates most lifetime stretch distributions and requires most beneficiaries to withdraw the entire account balance within ten years.

The economic loss to these beneficiaries is significant because the average age most people inherit IRAs is between ages 50-55, and they are already at their peak income-earning years. Therefore they’d ideally “stretch” the inherited IRA payments over their lives, but they no longer can do so.

Naming a charitable remainder trust may increase the tax savings for beneficiaries compared to using the new ten-year rule for distributions. Individuals who leave a surviving spouse have most, but not all, of the same “stretch IRA” options they had before 2020. The surviving spouse can still roll the IRA over to their own IRA and not take distributions until age 72.

Eligible Designated Beneficiaries

In addition to the above, there is still much to consider because, after the death of the surviving spouse, the payout to or for children or other beneficiaries will typically have to be distributed within ten years for “designated beneficiaries” if things are set up correctly, or within five years if not done correctly. Specific recipients can still stretch the inherited retirement plan over their lifetimes. The exceptions to the ten-year rule include the following:

- Individuals who are less than ten years younger than the deceased participant.
- A disabled or chronically ill individual.
- A child until she reaches the age of majority.
- A surviving spouse.

No Creditor Protection When IRA is Left Directly to Loved Ones

In 2014 the Supreme Court’s decision of *Clark v. Rameker* acknowledged that while the bankruptcy code is intended to protect the retirement accounts of debtors, it is *not* meant to protect the inherited IRAs. Because inherited IRAs do not allow for contributions or have no early withdrawal penalties associated with them, the unanimous Supreme Court decision acknowledged that inherited IRAs are “freely consumable” by the beneficiary and thus are available to the beneficiary’s creditors well.

For those counting on the bankruptcy code to protect an inherited IRA, the Supreme Court decision will now leave them exposed. The *Clark* decision made it more appealing to leave inherited retirement accounts to loved ones in trust than directly from a proactive planning perspective. The challenge now in 2020 is that the SECURE Act reduced the creditor protection that traditional trusts have offered retirement assets. (More on “conduit” trusts below).

Traditional Trust Planning with Retirement Assets

Because retirement assets are typically the most significant asset in an individual’s estate, special planning must ensure the beneficiaries inherit these assets most optimally, customized for each beneficiary. Before 2020, retirement assets could be payable to a “see-through” trust. These IRA trusts are known as either “conduit” trusts or “accumulation” (or discretionary) trusts.

Under the old rules, if the IRA trust qualified as a see-through trust, the trust beneficiaries were treated as if they were named directly, and the stretch payout was permitted. RMDs are paid from the inherited IRA to the trust and distributed to the trust beneficiaries annually with a conduit trust. With a conduit trust, the beneficiaries paid tax on the RMDs at the beneficiary’s tax rate.

With an accumulation trust, the trustee has the discretion to decide whether to pay out the RMDs immediately to the trust beneficiaries or instead retain the assets in the trust to preserve the funds. Unfortunately, when the RMD funds are kept in the accumulation trust, they are taxed at the high trust tax rates instead of being taxed directly to the beneficiaries.

In 2020 and beyond, the problem with the conduit trust is there are zero RMDs, and at the end of the ten years, the entire balance in the inherited IRA would be paid out to the beneficiaries. This results in no funds remaining protected in the trust after ten years and leaves recipients with a mega tax bill.

Since this is an accumulation trust, the trustee does not have to pay out all of the funds to the trust beneficiaries, so the funds could remain in the trust and be protected, but at a cost. If an accumulation trust is a beneficiary, all of the inherited IRA funds would have to be paid to the trust by the end of the ten years. After those ten years, the entire trust would be taxed at federal trust tax rates, which are taxed at 37% over just $12,950 of income in 2020.

IRA Assets Left to Testamentary CRT	IRA Assets Left to Accumulation Trust
Longer stretch	Simple
Forces heirs to take IRA inheritance out slowly	Trust is over between 10-11 years
Family recognition and examples established for charitable purposes	Families with no charitable intentions do not need to worry about what eventually transfers to charity

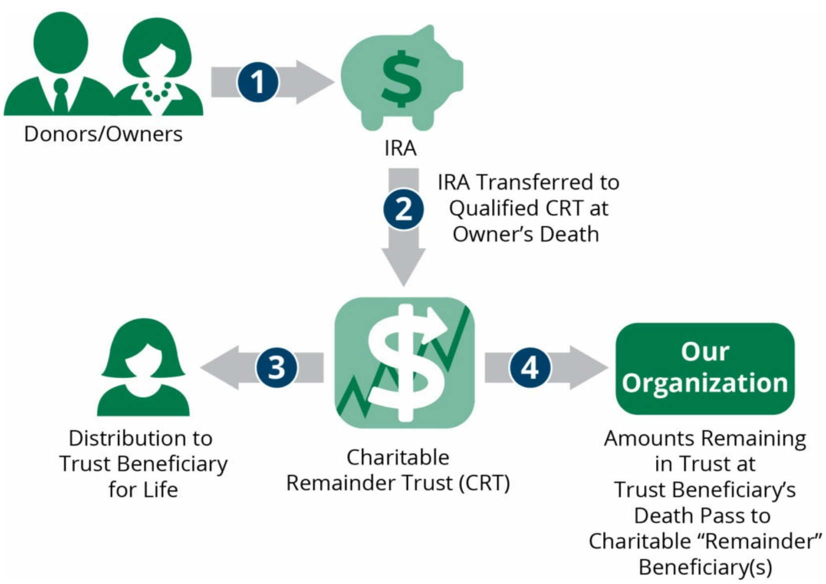
No “multiple trust rule” so that a separate Equalization Trust can be used without income tax issues	
Lower-income brack family members may serve as trustees to have the family receive more.	
No limit on what can go to charity	

Comparing characteristics of a TCRT vs. an Accumulation Trust after beginning in 2020

Testamentary Charitable Remainder Trusts

For donors who wish to provide for charity with an estate gift and establish a reliable income stream to one or more heirs, using retirement plan assets to fund a testamentary charitable remainder trust (TCRT) can be an effective way to accomplish both goals. In a series of favorable private letter rulings, the IRS determined that such a transfer would not trigger federal income tax on the entire balance.[1] Instead, the income tax is applied only as this income is distributed individually to the income beneficiaries of the CRT.

At the passing of the IRA owner, all the money leaves the IRA to the CRT, and no income tax is paid. Now the charity will receive the IRA, but before it does, the donors loved ones will get income for the rest of their lives based on the entire 100% of the value of the IRA instead of rather than only 60% after taxes are paid.



Example

In 2020 Vivian Smith, age 80, is revising her estate plans for her son Tom, age 45. Unfortunately, Tom is going through a divorce at this time and has been between jobs. Vivian’s most significant asset is her IRA, and she named her son Tom the IRA’s only designated beneficiary. In 2025, at Vivian’s death, Tom is age 50. The value of Tom’s inherited IRA is $500,000. Let’s look at three potential outcomes that Vivian can control as she reviews her estate plans in 2020.

Assume first that Tom is not the most financially sophisticated. In 2025, he immediately withdraws the IRA account and pays income taxes at an effective rate of, say, 45% (federal and state combined); his net after-tax value is $275,000. Even worse, imagine that Tom has serious debts From his divorce, and his creditors can take the entire retirement plan before he receives any benefit.

Second, assume Tom clears up his creditor problems independently (By 2035) and is wise enough to maximize his deferral. Hence, he instead waits ten years and then withdraws the entire account. Also, assuming that the rate of investment return inside the inherited IRA is 7% and Toms's after-tax rate of return is 3.9%, his after-tax net present value is $370,771, which is certainly an improvement of $95,771 compared to the first outcome.

Vivian Smith initially didn't intend to leave any of her IRAs to charity but is pleased to support her church. Vivian will also provide a lifetime "stretch" of payments to Tom and protect the asset from creditor issues.

Finally, assume that Back in 2020, Vivian back establishes and names as the IRA's beneficiary a testamentary charitable remainder unitrust (CRUT), paying Tom 5% of the trust's value each year (5% unitrust) for life, assuming that the CRUT earns an annual return on investment of 7% and makes payments to Tom at the end of each year.

Vivian decides that she wants the trustee to have the "sprinkling" authority to allocate the income between the beneficiaries. So she makes both Tom and her church income beneficiaries. If Tom makes poor life choices, the trustee can allocate income to the church instead of Tom. However, if Tom remains employed and passes random drug tests, Tom can expect to continue to get the complete 5% of the payments each year of his life.[2]

Tom lives to age 87, and the present value of his income payments when the CRUT is funded is $668,811. Additionally, the present value of the charity's remainder interest is $81,132 (a 7% discount rate assumed because neither the CRUT nor the charity pays income taxes). This result significantly improves $393,811 over the first outcome if Tom takes an immediate lump sum.

Conclusion

Those willing to "pledge" part of their retirement assets to charity can still provide the "stretch IRA" experience for their adult children and leave a charitable legacy. For affluent families large enough to owe federal estate tax, a transfer of retirement plan assets into a charitable remainder trust is eligible for an estate tax deduction in addition to the income tax deferral for beneficiaries to "stretch" the payments over their lifetimes.

Suppose someone has designated a trust as the beneficiary of their retirement accounts. In that case, they should review the drafting of that trust with an estate planning attorney to understand the implications of the SECURE Act. With careful attention by your estate planning attorney, a trust can be designed to hold an IRA that does not need to distribute all IRA withdrawals within ten years and may instead accumulate those withdrawals (but at higher trust income tax rates). Those with some charitable intent can establish a trust that can pay income for the lifetime of their children, or other loved ones, at their own (likely lower) income tax rates.

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[1] See PLR 9237020 and PLR 9253038, which address IRA's and 401k assets

[2] This clause should not disqualify the trust [IRC §674(c), Rev. Rul. 77-73, PLR 9052038], although naming a charity as an income beneficiary does not increase the donor'sincome tax charitable deduction Reg. §1.664-3(d).

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This information is not intended as tax, legal or financial advice. Gift results may vary. Consult your personal financial advisor for information specific to your situation.

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