THE CATHOLIC FOUNDATION

The Sweet Life: Charitable Gifts of Retirement Assets

In This Issue:

- Qualified Charitable Distributions: Making a Gift Directly from an IRA to Charity
- Other Gift Options Using Retirement Assets: Beneficiary Designations, Rollovers, and Cashing Out
- A Multipurpose Gifting Option: A Stretch IRA Alternative that Meets Charitable Goals

Creamy milk chocolate, earthy dark chocolate, smooth white chocolate—in any form, this treat appeals to almost every sweet tooth on the planet. Chocolate comes from the fruit of native South American trees called Theobroma cacao, which is Greek for "food of the gods."[1] This nearly magical food is reported to protect the heart (with its phytonutrients) and create a positive mood (through the release of endorphins).[2]

Charitable giving is also good for the heart (although not in the same way as chocolate or exercise) and it produces positive feelings in the giver. Using retirement assets to make gifts not only feels good, but can provide unique benefits and opportunities.

Qualified Charitable Distributions: Making a Gift Directly from an IRA to Charity

Qualified charitable distributions (QCDs) became one of the more popular giving methods thanks to the Pension Protection Act (PPA) of 2006. The PPA gave IRA owners the option of making charitable contributions directly from the IRA to a qualified charity.[3] Both donors and charities found great value in this new giving option, making it almost as popular as chocolate! QCDs are sometimes referred to as IRA charitable rollovers—while not technically a rollover, an individual age 70½ or older can donate money (up to $100,000 per year) directly from an IRA to a charity. The amount distributed counts toward the individual's required minimum distribution (RMD) if one is due and is not considered income to the donor.

Legislative History

The PPA

The section of the PPA that authorized qualified charitable distributions was not permanent, and for years taxpayers waited nervously during each session to see if Congress would reauthorize it.

The PATH Act

Finally, in 2015, Congress passed the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act) which made QCDs permanent.[4] Under the Internal Revenue Code at the time of the PATH Act, an IRA owner had to begin taking required minimum distributions at age 70½, without regard to financial circumstance or need.[5] Failure to take an RMD results in an IRS penalty of 50% of the amount that should have been taken but was not—a hefty fine![6]

For example, if Rainbow Bonka, the 74-year-old former VP of Candy Sprinkles for Bonka Candy Company, owned an IRA but refused to take his required minimum distribution of $9,000, Rainbow would be subject to a penalty of $4,500 for failing to take the RMD. If he took $5,000, he would still be penalized for failing to take the remaining $4,000—a penalty of $2,000.

The SECURE Act

In late 2019, Congress passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which raised the age individuals must begin taking RMDs from 70½ to 72 beginning in 2020.[7] However, it is important to note that the SECURE Act did not change the age for making a qualified charitable distribution—that option is still available starting at age 70½.

Under the current Internal Revenue Code, the donor must direct the IRA administrator to make a distribution of up to $100,000 directly to a qualified charity.[8] If the IRA owner first receives the distribution, even if they immediately donate the funds, they have not made a QCD and will be taxed on the amount distributed (in other words, there is no "60-day rollover rule" for QCDs). The amount of this distribution is not includible in gross income, meaning the donation has no impact on the donor's charitable limitation.[9] Further, since a QCD has never provided a charitable deduction for donors, it continues to be a good option for those who no longer itemize deductions after the Tax Cuts and Jobs Act of 2017. Let's look at an example.

Billy Bonka never achieved the legendary status that his second cousin found with his chocolate factory, but nevertheless, Billy's job working with chocolate provided him with a comfortable life and a well-funded retirement. When Billy retired at the age of 72, he began to look for additional ways to support his favorite charities. After speaking with professional advisors, this maestro of confection realized he was neglecting a tremendous source of potential donations—his retirement assets!

Billy had an IRA from which he needed to begin taking an RMD of $10,000. However, since Billy's financial situation was solid, he did not need the RMD. Instead, Billy directed his IRA administrator to make a qualified charitable distribution of the full RMD amount to Billy's favorite qualified charity. The administrator facilitated a transfer directly from the IRA to the charity, and Billy obtained a contemporaneous written acknowledgement from the charity for the gift.

At tax time, Billy's tax preparer noted on Billy's return that the full amount of the RMD was a QCD. While Billy did not qualify for an itemized charitable deduction, he paid no tax on the donated RMD. In addition, the QCD had no impact on Billy's overall charitable giving limitation, meaning Billy could still claim a deduction for other charitable gifts.

NOTE: For 2021, donors may deduct cash gifts to qualified charities up to 100% of AGI (up from the usual 60%) under the Consolidated Appropriations Act, 2021.

Rules

Of course, a donor must follow all the rules in order to properly make a QCD.

Qualified charities

In order to qualify for the preferential treatment, the distribution from the IRA must be made directly from the IRA to the qualified charity.[10] A qualified charity includes:

1. a charity described in section 170(c)(2);
2. certain veterans' organizations, fraternal societies, and cemetery companies; and
3. a Federal, State, or local governmental entity (but only if the contribution is made for exclusively public purposes).[11]

Neither a donor-advised fund nor a supporting organization is considered a qualified charity for the purposes of a QCD.

Additionally, the distribution will be treated as a qualified distribution only if a deduction for the entire distribution would be allowable under IRC §170. If the deduction is not includible in gross income, the IRC provides that the qualified charitable distribution will not be taken into account in determining the charitable deduction.[12]

Multiple IRAs

The limitation of $100,000 applies to all qualified charitable distributions during a year. A donor with multiple IRAs may not make QCDs of $100,000 each from multiple accounts—this would exceed the threshold. However, the donor could make QCDs of $50,000, $30,000, and $20,000 from three separate IRAs during the same year and fall within the limitation.

Keep in mind that both the donor and the donor's spouse may make qualified charitable distributions up to the $100,000 threshold.

Cautions

Although chocolate provides health benefits, it also adds calories, so overindulging can result in a number of health issues. As with most things in life, being careful and following good eating practices can help chocolate lovers avoid issues. Donors and charities must also exercise similar care in following good giving practices regarding QCDs.

Personal benefit

The Joint Committee on Taxation noted in its report: If a donor receives any personal benefit as a result of the QCD, the entire amount of the distribution will be disallowed unless the donor can demonstrate, among other things, that the fair market value (FMV) of the distribution exceeds the FMV of the benefit received from the charity.[13] This means that charities must be careful in soliciting potential donors with free meals or events. Likewise, a qualified charitable distribution cannot be made in exchange for a charitable gift annuity.

Substantiation

Donors must also be aware of and comply with the same substantiation requirements that apply to charitable deductions. The donor should make sure to obtain written confirmation from the charity for the QCD. This confirmation should contain the amount of the donation and a statement that:

- the charity received the donation directly from an IRA
- the charity is a qualified charity
- it was the donor's intent that the gift qualify as a QCD
- the donor did not receive any goods or services in exchange for the distribution

Nondeductible contributions

If a donor owns an IRA with nondeductible contributions, there is a special rule to determine the portion of the distribution that is includible in gross income and thus is eligible to be used as a QCD. Under the rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income if all the owner's IRAs were distributed in a single year (except for the QCD). In determining the amount of subsequent IRA distributions includible in income, adjustments are made to reflect the amount treated as a QCD.[14]

Non-IRA gifts

Donors with savings in other retirement funds like 401(k)s, 403(b)s, SEPs, SIMPLEs, or pensions funds may want to make their own similar charitable distribution. However, like the kid outside the candy store, these individuals may only peer through the window and dream. Other retirement accounts are not eligible to make qualified charitable distributions.

Other Gift Options Using Retirement Assets: Beneficiary Designations, Rollovers, and Cashing Out

Consumers are accustomed to buying an assorted box of chocolates. It might contain dark chocolates, milk chocolates, and chocolates filled with cream, caramel, nuts, or even cherries. An individual's retirement savings may be similarly varied, with some combination of traditional pension plans, qualified plans (401(k), 403(b), 457(b), etc.), or IRAs. This variety may be beneficial, but when using retirement assets to make charitable gifts, each plan has its own restrictions. For example, as we just discussed, the option to make a qualified charitable distribution is only available for IRA assets, and only if the IRA owner is age 70½ or older.

While the QCD is a simple and powerful way to use retirement assets to make a gift, there are many other gifting options available that make use of retirement assets. A few of the more common options are beneficiary designations, rollovers, and cashing out.

Beneficiary Designations

Perhaps one of the easiest ways to make a gift of retirement assets is to designate a charity as a beneficiary of a qualified retirement plan or IRA. To make this revocable gift, the donor must contact the plan administrator to discuss any requirements for adding a beneficiary designation. The plan administrator will send the donor the necessary beneficiary designation form. In completing the form, the donor must make certain to use the charity's correct legal name and address, as well as naming a contact person for the charity.

The donor can name the charity as the primary beneficiary or secondary beneficiary (to receive the money only if the primary beneficiary cannot). The charity can be the sole beneficiary or the donor can name multiple beneficiaries. Properly designating beneficiaries provides the donor with additional assurance that hard-earned retirement funds will be used in the exact way the donor envisioned.

Making Use of a Rollover

There are many reasons people choose to roll money from a 401(k) or other retirement plan into an IRA. Those who do this may realize that it comes with an additional benefit—the ability to use a QCD to make charitable donations, assuming the donor is age 70½ or over. Many accounts—including traditional IRAs, SIMPLE IRAs, 401(k)s, 403(b)s, and 457 plans—can be rolled directly from one account into another without penalty or income tax.

> **The exception to the tax-free rollover**
> The exception is rolling assets into a Roth IRA or Roth-designated account. This will result in income tax on the amount rolled over, but those assets will then be available for tax-free withdrawal.[15]

A rollover can be done in one of two ways:

- **A direct rollover** is a distribution in which the taxpayer never receives the assets. Instead, the administrator of the original plan transfers the assets directly to the administrator or trustee of the new retirement plan or account. The administrator of the transferring fund will often issue a check to the taxpayer that is payable to the new fund for the benefit of the taxpayer. The taxpayer will then forward the check to the new fund to complete the transfer. Since the check is made out to the new plan for the benefit of the taxpayer, it is not treated as a taxable distribution to the taxpayer.[16]

- **A rollover distribution** is a distribution in which the taxpayer actually receives the assets. The administrator sends a check from the transferring plan payable to the taxpayer. In this case, the taxpayer must complete the transfer of the full amount of the funds to a new account within 60 days of the distribution.[17] The big downside is that rollover distributions are subject to the mandatory 20% withholding from the rollover amount from an employer plan or 10% withholding from an IRA.[18] As noted above, the taxpayer then has 60 days to deposit the full amount of the funds into a new retirement account, meaning the taxpayer will have to chip in the amount of the mandatory withholding. Obviously, this is less than ideal—if circumstances allow, the direct rollover is the preferred method.

Example: John is 72 and has significant assets in a 401(k). However, he also has other sources of retirement income that are more than sufficient for his needs. He would like to use the money in the 401(k) to support his favorite charities, but qualified charitable distributions are not allowed from a 401(k). John decides to complete a direct rollover of a portion of the 401(k) into an IRA. Following the completion of the rollover, as allowed under the IRC, John begins making qualified charitable distributions to his two favorite qualified charities. These distributions satisfy his RMD requirements for the IRA.

The IRS specifies which types of distributions can be rolled over and which cannot.

IRAs

A taxpayer can roll over all or part of any distribution from an IRA except:

- Required minimum distributions
- Distributions of excess contributions and related earnings

Retirement plans

A taxpayer can roll over all or part of any distribution from a retirement plan account except:

- Required minimum distributions
- Loans treated as distributions
- Hardship distributions
- Distributions of excess contributions and related earnings
- A distribution that is one of a series of substantially equal payments
- Withdrawals electing out of automatic contribution arrangements
- Distributions to pay for accident, health, or life insurance
- Dividends on employer securities
- S corporation allocations treated as deemed distributions

A taxpayer should consult an attorney to thoroughly review the treatment a particular situation warrants.

Cashing Out

For donors who no longer need the assets in their retirement funds (often, a donor who has other assets sufficient to cover expenses throughout retirement), it is possible to simply cash out all or part of a retirement account and donate the money to charity. The donor's age, however, makes a difference in this situation since different tax treatment applies to donors under 59½, as well as those over 70½.

Donors under 59½

These donors may face a 10% tax penalty on any early withdrawal that does not fall under one of the exceptions allowed in the IRC. Typically, exceptions include these distributions:

- The owner's death or total and permanent disability (both qualified plans and IRAs)[19]
- Purchase of a home, up to $10,000 (IRAs only, not qualified plans)[20]
- Alternate payee under a Qualified Domestic Relations Order (QDRO) (qualified plans only, not IRAs)[21]
- Certain qualified higher education expenses (IRAs only, not qualified plans)[22]
- An amount of unreimbursed medical expenses (both qualified plans and IRAs)[23]
- Birth or adoption of a child, up to $5,000 (both qualified plans and IRAs)[24]
- Timely made corrective distributions of excess contributions, excess aggregate contributions, and excess deferrals (qualified plans only)[25]

- Certain distributions to qualified military reservists called to active duty[26]

In addition to the early withdrawal penalty, a taxpayer under 59½ would also have to pay income tax on any distribution. Distributions from an IRA, whether paid in a lump sum or installments, are taxable under the Section 72 annuity rules.[27] Distributions from qualified retirement plans are includible in the participant's gross income. Depending on the plan terms, distributions may be taken as annuity payments, periodic installments, partial distributions, or a lump-sum distribution. Qualified retirement plans stipulate the normal form of benefit under the plan. It is possible that a married participant must have the spouse's written consent to elect a form of benefit other than a qualified joint-and-survivor annuity.

Donors 70½ and older

Donors who have reached age 70½ have the advantage of using a qualified charitable distribution to make a donation to a qualified charity directly from an IRA (but no other type of retirement account), and do not have to be concerned about the penalty on distributions. For these IRA owners, retirement funds become an easy and valuable source of charitable giving.

A Multipurpose Gifting Option: A Stretch IRA Alternative that Meets Charitable Goals

Before the SECURE Act of 2019 took effect, many estate owners chose to pass their IRA retirement savings to children or grandchildren at death using a "stretch IRA." While the original owner faced annual required minimum distributions (RMDs) beginning at age 70½ (now age 72), the beneficiaries of the inherited IRA could take RMDs based on a longer life expectancy. Stretching these smaller RMDs out over the lifetime of a younger beneficiary (often a grandchild) meant IRA assets continued to grow tax deferred for a significantly longer amount of time.

Beginning in 2020, however, the SECURE Act requires most non-spouse beneficiaries to withdraw the entire amount from an inherited IRA within 10 years.[28] This diminishes the tax benefits of the "stretch" and reduces the amount the beneficiary ultimately receives. For IRA owners with charitable goals, there is an effective way to mimic the previous stretch IRA by making a testamentary transfer of an IRA to a charitable remainder trust (CRT).

The CRT can make annual payments to one or more designated individuals for life (or for a period up to 20 years) before passing the remainder to charity. There are two types of CRTs—a charitable remainder annuity trust (CRAT) pays out a fixed dollar amount and a charitable remainder unitrust (CRUT) pays a fixed percentage of trust assets (as revalued annually).

Unlike an individual IRA beneficiary, the trust can receive the IRA proceeds without immediate income taxation, so the entire amount can be invested to benefit the CRT beneficiaries. To implement this strategy, the donor takes the following steps:

- **Establish a CRUT.** A CRUT offers more flexibility than a CRAT and is therefore generally recommended. All CRTs must be funded with sufficient assets to cover the associated administrative costs and trustee fees. The donor should get professional tax advice as the taxation of CRT proceeds can be complicated.[29]
- **Name the CRUT as the beneficiary of the IRA.** At death, the donor's IRA will be distributed to the CRUT. No income tax is due on this distribution, nor on any growth within the trust. The IRA will be included in the donor's gross estate for estate tax purposes, but the estate will receive a charitable deduction based on the remainder interest the charity is expected to receive when the CRUT terminates.[30]
- **Designate the individual and charitable beneficiaries of the CRUT.** The individual beneficiaries will most often be children or grandchildren, but the donor could name a spouse as a beneficiary, with trust payments continuing to the children at the spouse's death. As beneficiaries pass away, portions of the trust remainder will go to the designated charity.
- **Consider the payment options.** The donor must choose a specified percentage of the trust assets as the payment amount for a CRUT. Of course, the actual payment amount will fluctuate as trust assets are revalued each year. The IRS sets a maximum payment amount to

make it more likely that the charity will receive a minimum percentage of the initial CRUT balance.[31] The donor must also select whether payments will last for life or for a period of years. Lifetime payments might seem to more closely approximate the old stretch IRA, but selecting a 20-year payment period may be more beneficial, as a beneficiary could die shortly after the CRUT takes effect.

Using a CRT to replace the old stretch IRA has several advantages. The donor can leave as much of the IRA as possible to heirs, stretched over a longer period of time and with a lower tax impact. It gives the donor control over the rate at which heirs can access the funds. In addition, of course, it uses retirement assets to fulfill meaningful charitable goals and provides the donor's estate with a charitable deduction for the value of the CRT's charitable remainder interest, as calculated under IRS guidelines.

Selecting the Best Option

After opening a box of assorted chocolates, a chocolate lover often experiences joy, excitement, and then a moment of indecision—which one to choose first? A donor with sufficient retirement assets may feel the same as they review their assets with a financial professional. There may be the joy of realizing their lifetime of hard work has paid off, the excitement that comes with beginning a new chapter of life, and then perhaps a moment of indecision—how to best apply their savings to accomplish their goals? Fortunately, using retirement assets to make charitable donations can help the donor to realize both personal and philanthropic goals, leaving other assets to provide a well-deserved and secure retirement.

ENDNOTES

1 Jessie Szalay, "Chocolate Facts, Effects & History," Live Science, March 28, 2018.
2 Of course, as with everything, chocolate must be used in moderation. No one should be happy all the time.
3 Public Law 109–280, 120 Stat. 780, enacted August 17, 2006.
4 PATH Act of 2015, PL. 114-113.
5 IRC §401(a)(9).
6 IRC §4974(a).
7 Public Law 116-94.
8 IRC §408(d)(8).
9 IRC §408(d)(8)(A).
10 IRC §408(d)(8)(B).
11 See: IRC §170(c)(3)-(5) and §170(c)(1).
12 IRC §408(d)(8)(E).
13 Technical Explanation Of The Protecting Americans From Tax Hikes Act Of 2015, House Amendment #2 To The Senate Amendment To H.R. 2029 (Rules Committee Print 114-40).
14 IRS Publication 590-B.
15 IRC §402(c).
16 IRS website (www.irs.gov), "Rollovers of Retirement Plan and IRA Distributions," last updated February 6, 2020.
17 IRC §402(c)(3)(A).
18 Reg. Sec. 3405(c)(1)(B).
19 IRC §72(t)(2)(A)(ii) and (iii).
20 IRC §72(t)(2)(F).
21 IRC §72(t)(2)(C).
22 IRC §72(t)(2)(E).
23 IRC §72(t)(2)(B).
24 IRC §72(t)(2)(H).
25 IRC §§401(k)(8)(D), 401(m)(7)(A), and 402(g)(2)(C).
26 IRC §72(t)(2)(G).
27 IRC §408(d)(1).
28 IRC §401(a)(9)(H)(iii).
29 Taxation is based on a tiered regime. See: Reg. Sec. 1.664-1(d)(1)(i)(B).
30 Reg. Sec. 1.664-4.
31 Reg. Sec. 1.664-4(e)(6) and IRS Pub. 1458.
32 Reg. Sec. 1.664-4.

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