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THE Good Advisor

Storm Chasers and SECURE 2.0: How Financial Professionals Can Help Guide and Reassure Clients

For most people, the threat of a tornado, hurricane, or other severe weather brings a sense of trepidation. These weather events are uncommon, unpredictable, and potentially dangerous, requiring people to take action and seek shelter to ensure their own protection. For storm chasers, however, a severe forecast is cause for excitement as they head directly toward the storm. Beginning in 1956 with David Hoadley's *Storm Track* magazine (the first to focus on storm research and bringing storm chasers together) and boosted by the 1973 Tornado Intercept Project between the University of Oklahoma and the National Severe Storms Laboratory,[1] storm chasing has proven to be more than just a thrill (for the chasers and those who watch them from the comfort of their own homes), but an important way to gather useful data.

New legislation can feel like a storm to clients, who may approach the changes with trepidation, unsure how to best protect themselves and their finances. Financial professionals lead the way. Like storm chasers, they get close enough to learn key information, analyzing changes and anticipating the impact. Perhaps most importantly, they share that information, using it to reassure clients and guide them on how to keep their financial picture secure.

Passed in December 2022 as part of a $1.65 trillion Consolidated Appropriations Act of 2023, the SECURE 2.0 Act includes little for clients to fear. In this issue, we look at the key charitable giving provision of SECURE 2.0 and how clients can use it to make a gift and secure an income.

Qualified Charitable Distributions—A New Option for Giving

Section 308 of the Consolidated Appropriations Act amended Section 408(d)(8) of the Internal Revenue Code (IRC) to provide for a new qualified charitable distribution (QCD) option for any IRA owner age 70½ or older who wants to make a charitable gift and secure a lifetime income stream.

The Traditional QCD

Before SECURE 2.0, the IRC allowed IRA owners age 70½ or older to make a distribution directly to a qualified charity under the qualified charitable distribution provision (sometimes called a charitable rollover).[2] Donor-advised funds and supporting organizations are not considered qualified charities. The IRA distribution is treated as a QCD only if a deduction for the entire distribution would be allowable under IRC §170.

This QCD amount, up to the annual aggregate limit of $100,000, is not includible in gross income, meaning the donation has no impact on the donor's charitable limitation. There is no charitable income tax deduction for a QCD (which works well for the many donors who no longer itemize deductions after the Tax Cuts and Jobs Act of 2016), but no tax is due on the distribution and the distributed amount counts toward the donor's required minimum distribution (RMD) if one is due.

Increase in RMD starting age

Under SECURE 2.0, owners of traditional IRAs and qualified defined contribution plans (including profit sharing, money purchase, 401(k), and 403(b) plans) must begin taking RMDs by age 73 (up from 72). A further increase to age 75 is scheduled for 2033.

The New QCD Option Under SECURE 2.0

The SECURE 2.0 Act added a new subparagraph to the Code at IRC §408(d)(8)(F), creating a new QCD option for IRA owners age 70½ or older in addition to the traditional option. This allows a one-time distribution up to $50,000 directly from an IRA to create a new charitable gift annuity (CGA) or charitable remainder trust (CRT), which can either be a charitable remainder unitrust (CRUT) or charitable remainder annuity trust (CRAT). Like the traditional QCD, no deduction is allowed, but the tax-free distribution counts toward the donor's RMD if one is due. However, this option allows the donor to not only make a gift but also secure a source of income.

The CGA or CRT must qualify for an income tax charitable deduction under the current IRC. That means the CGA or CRT must pass the 10% minimum income tax charitable deduction test. In addition, the CRT must have a minimum payout rate of 5%, and in the case of a CRAT, the trust must pass the 5% probability test. The CGA must have a minimum 5% payout rate.

Other specific requirements include the following:

- Spouses may contribute $50,000 each from their own IRAs to a single CRT or a joint-life CGA.
- CGA or CRT payments may only go to the donor and/or the donor's spouse—not to children or other beneficiaries.
- CGAs must be immediate, not deferred.
- CGA or CRT payments are treated entirely as ordinary income and are subject to the federal income tax. No portion of any payment will be considered tax free or taxed as capital gains.

QCD Inflation Indexing

The $100,000 and $50,000 limits for the traditional and new QCD options, respectively, will be indexed for inflation beginning in 2024. This is also a change brought about under SECURE 2.0.

Charitable Remainder Trust—Review Plus New

A charitable remainder trust is an irrevocable trust that provides annual distributions to the donor and/or one or more noncharitable beneficiaries designated by the donor for life or a specified period up to 20 years. At the end of the trust term, the remainder interest in the trust is paid to a qualified charity. This is a powerful way to make a significant gift while also supplementing retirement income or providing for loved ones.

CRTs come in two forms. A CRAT pays out a steady income—a specified percentage of the initial trust assets—not less than annually.[3] A CRUT pays out a variable income—a specified percentage of the annually revalued trust assets.[4] A CRUT can accept additional funding while a CRAT cannot.

CRT income payments are tax-advantaged, as income is taxed in four tiers—ordinary income, capital gain income (with net short-term capital gains distributed before net long-term capital gains), "other income" (which generally means tax-exempt income), and tax-free return of principal.

The CRT is a gift of a remainder interest (to the charitable remainderman) with a retained income interest (for the amounts paid to the income beneficiary). To qualify as a split-interest trust that generates an income tax deduction for the donor, the CRT must meet criteria described under IRC §664(d).[5] The future charitable interest qualifies for a charitable deduction equal to the present value of the remainder interest in the year the trust is created.[6]

NOTE: A CRT funded with the new QCD option *does not qualify* for a charitable income tax deduction, and whether it is a CRAT or a CRUT, it cannot accept any additional funding. In addition, the noncharitable beneficiaries are limited to the IRA owner and/or the owner's spouse, and all income payments are taxed only as ordinary income.

EXAMPLE: Abby is 74 and retired from a career as a software engineer. She owns an IRA with a significant balance. As a result of their other investments, Abby and her husband Rick (also 74) do not need the RMD she must take from her IRA. Abby and Rick have embraced a lifetime commitment to charitable giving to a handful of charities but give consistently to one favorite charity. They decide to take advantage of the new QCD option to fund a charitable remainder trust from Abby's IRA.

Working with her attorney, Abby creates a new CRAT. She directs her IRA custodian to make a tax-free transfer of $50,000 directly into the CRAT. This transfer fulfills her RMD requirement for the year. According to the terms of the CRAT, Abby and Rick will receive annual payments of $2,500 for 20 years (taxed as ordinary income), at which point the remainder will go to their favorite charity.

Charitable Gift Annuity—Review Plus New

A charitable gift annuity is a contractual agreement between the donor and the charity. The donor agrees to make an irrevocable charitable gift (often cash or long-term appreciated stock), and in return, the charity agrees to pay a fixed amount periodically for the lifetime of one or two annuitants. Income payments can begin immediately or be deferred to some future date.

However, the transaction is not merely a "quid pro quo" between the donor and charity. Since the present value of the donor's annuity is less than the value of the property transferred, the transfer is considered part charitable gift, part annuity purchase. The donor qualifies for a tax deduction for the gift portion of the transaction.

Annuity payment amounts depend on the amount of the gift and the age of the annuitant(s). In addition, deferred gift annuities result in higher payment amounts. Payments are tax-advantaged, as they may be taxable as a tax-free return of principal, long-term capital gain, and ordinary income.

New Higher ACGA Rates

The American Council on Gift Annuities (ACGA) publishes suggested gift annuity payout rates that are revised periodically. The ACGA announced new, higher rates effective January 2023, presenting donors with the opportunity to lock in higher rates when establishing a fixed lifetime income stream for one or two people.

Sample one-life gift annuity rates, effective January 1, 2023

Age	70	75	80	85	90
Rate	5.9%	6.6%	7.6%	8.7%	9.7%

NOTE: A CGA funded with the new QCD option must begin immediately, *does not qualify* for an income tax deduction, and must be non-assignable. The annuitants are limited to the IRA owner and/or the owner's spouse. In addition, annuity payments are taxed entirely as ordinary income.

EXAMPLE: Juan and Reina, both age 75, met in Marine Corp basic training and eventually married while serving their country. After retiring from the military, Juan opened and ran a popular lunch counter, and Reina started up her own private security firm. After the successful sale of both businesses, Juan and Reina are now retired and financially secure. They each have an IRA with a significant balance, but due to their sound financial decisions, they do not need the income from their RMDs.

This year, they decide to use the new QCD option to fund an immediate charitable gift annuity with their favorite charity. They each ask their IRA custodian to transfer $50,000 into a new joint-life CGA, for a total of $100,000. Juan and Reina will receive $5,800 per year for life—an amount that will be fully taxed as ordinary income.

Weathering the Storm

Predicting the arrival of severe weather almost always includes some type of estimation, with forecasters often using percentages to provide those in the potential path of the storm with a sense of the possible outcomes. At times, legislation being considered in Congress can be as uncertain as the threat of severe weather. SECURE 2.0 had a few iterations, then appeared to be dead before being resurrected and included in the final version of the Consolidated Appropriations Act of 2023. As a financial professional, you certainly can't forecast the actions of Congress, but when Congress does take action, you have the experience and education to provide your clients insight on how any new items may impact their estate and financial planning.

ENDNOTES

1 "A History of Storm Chasing," *MetMatters*, June 26, 2018.
2 IRC §408(d)(8).
3 Treas. Reg. Sec. 1.664-2.
4 Treas. Reg. Sec. 1.664-3.
5 26 U.S.C. 664(d).
6 26 U.S.C. 2522(c)(2).

Access more information now.

An electronic copy of our companion booklet with additional information on other new provisions of the SECURE 2.0 Act is available in the *Professional Advisor* section of our website at www.catholicfoundation.com.

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