

[Jeffrey Frye](#) - Thu, 11/14/2024 - 15:00

The Qualified Charitable Distribution (QCD) from traditional IRAs is not new; it has been around since 2007. The Tax Act of 2006 ushered in this unique provision that allows distributions from traditional IRAs made directly to charities to escape the normal income tax on money taken out of a retirement plan. The donor is allowed to exclude the amount of the QCD from taxable income, but the offset is that there is no charitable income tax deduction for the gift being made to charity.

This provision was so well received that it kept being extended into additional years. The maximum amount for calendar years 2007 through 2023 was \$100,000. The provision was quite specific, however, in that it did not allow any kind of split-interest gift to be established using the money; donors could not use the amount of the QCD to fund a gift annuity or charitable remainder trust. This type of transfer was unofficially dubbed the “charitable IRA rollover” by the planned giving community, but that nickname was never used by the financial services industry. It was too easily confused with a “rollover IRA,” which is when a person transfers money from a different kind of retirement plan (401K, 403B, etc.) into a traditional IRA.

At the end of 2022, a major tax act was passed that changed the playing field for charitable gifts from traditional IRAs. The Tax Act of 2022 brought in a significant expansion of the IRA QCD provision. Beginning in 2023, for the first time, a person could use the QCD provision to establish a charitable gift annuity or charitable remainder trust. While this was the change the planned giving community had long desired, the new twist allowing the establishment of life income gifts was limited to once in a person’s lifetime. A person could use the QCD provision – up to \$50,000 – to establish one or more gift annuities or CRTs in 2023, but it was only for that one year. After that, the person would only be allowed to use the regular QCD to make outright gifts to charity.

There has been confusion about the QCD ever since 2007, because it deals with aspects of IRAs that many are unfamiliar with. The biggest area of confusion has been distinguishing the required minimum distribution (RMD) for a traditional IRA from a QCD. They are not the same thing. Not at all. And it is dangerous to confuse the two.

In order to understand the difference between a QCD and an RMD, one really needs first to understand what an RMD is. The required minimum distribution is the amount required by federal law that must be distributed from an IRA to the owner of the IRA in each calendar year. The whole idea behind the RMD is that the IRA represents lifetime earnings of the individual that have never been taxed. The legislation known as ERISA in the 1970's created the vehicles for American workers to set income aside for retirement and avoid paying tax right away on those earnings. The IRA is a tax-deferred account that allows the worker to salt away money for retirement free from any income tax during the working years. In theory, when the worker retires, he or she can - and WILL - withdraw money from the IRA and *pay tax on it at that point*. Note, the worker does not escape taxation on the income earned - they simply DELAY paying tax on the income.

Along with levying tax on the money once it is withdrawn from an IRA, the federal government also requires a minimum amount that must be withdrawn each calendar year. It's an official calculation that the administrator of the IRA is required to perform, and the administrator is required to notify the owner of the IRA exactly how much money must be taken out for each calendar year. The age upon which IRA distributions must begin was 70 ½ for a long time, but now the minimum age is 73. Once the IRA owner reaches 73, they have to take money out of the IRA each calendar year.

So, the RMD has been around for a long time. For many IRA owners, the RMD is not a problem at all - they WANT to take money out each year because they NEED it for basic living expenses. But for those individuals who have "well-funded IRAs" (the polite way of saying they have gobs of money in untaxed earnings), the annual letter instructing them to take out a certain dollar amount is quite unwelcome. Some IRA owners actually resent the federal government dictating how much money they have to "spend down" each year.

Since 2007, the IRA QCD has been an appealing strategy to such individuals. They have no choice about taking the RMD, but they MAY choose to do a QCD type of charitable gift. They get no income tax deduction for making the charitable gift, but more importantly, they are allowed to "write off" the distribution from the IRA. Lowering their taxable income by \$10,000 or \$50,000 or \$100,000 is much more beneficial than receiving a charitable deduction. The tax savings on a charitable deduction is only a portion of that amount (it's the dollar amount of the deduction multiplied by the person's marginal income tax bracket).

With the advent of the expanded QCD option beginning in 2023, owners of traditional IRAs have had the additional opportunity to transfer previously untaxed earnings to the charity(ies) of their choice and establish charitable gift annuities (CGAs) that pay them income for life. [They could even use the QCD money to establish a charitable remainder trust (CRT) – it is technically possible, but practically unlikely]. This has led to a whole new wave of confusion among the charitable gift planning community.

Now the options became overlapping – the IRA owner could transfer up to \$100,000 each year in the form of a QCD; that money could be used for an outright gift to charity. But also, the donor could choose to use a QCD to establish a charitable gift annuity – up to \$50,000 in 2023. The donor would not be taxed on taking the money out of their IRA, but also, they would not receive a charitable income tax deduction for any portion of the gift to charity. Moreover – and this is new – the tax categorization of the payments from the QCD-funded gift annuity would be as fully taxable ordinary income. There would be no tax-free income or capital gains distribution.

The question we have been most challenged to answer from some members of the gift planning community is why this new option makes sense at all. The QCD-funded gift annuity provides no income tax deduction, and the payments are fully taxable as ordinary income. Comparing this type of CGA to a regular cash-funded CGA, it looks like it's not such a great deal for the donor. But comparing a QCD-funded CGA to a conventional CGA is missing the biggest point: there is no tax on pulling the money out of the donor's traditional IRA. This is HUGE.

For owners of “well-funded” traditional IRAs, the RMD is an unpleasant fact of life. It doesn't matter that they would prefer to keep their money in the retirement plan – the federal government has a deliberate scheme to force them to spend down (at least some of) their retirement savings. The requirements don't take it to the extreme – the formulae do not cause IRA owners to zero out their balances by a certain age – but they force a significant amount of the money to be withdrawn AND TAXED over a period of time.

It is only when we consider this elite group of IRA owners that we can fully understand the appeal of the QCD, whether it is used for an outright gift or to establish a gift annuity. The IRA owner MUST take an RMD each year upon reaching the age of 73 – but they MAY do a QCD beginning at age 70 ½. It boils down to a

REQUIREMENT to withdraw money versus a CHOICE to make a charitable gift. Even if the donor - who is 73 or older - chooses to use a QCD to make a charitable gift, there is absolutely no requirement that forces the donor to match the amount of the RMD with the amount of the QCD. The donor may CHOOSE to do a QCD for whatever amount they want - up to \$105,000 in 2024 - but the amount is technically not related to the RMD. In some cases, the RMD will be for much less than the \$105,000, and the donor may choose to do a QCD for even less than the RMD amount. In other cases, the RMD may be in excess of \$105,000 (that means GOBS and GOBS of money in their IRAs), but the QCD can only be for a maximum of \$105,000 - not a penny more.

We hope this article has helped to clear up some of the mystery and confusion between the RMD of a traditional IRA and the possible QCD for a traditional IRA. This has been an area of confusion for many people in the charitable gift planning community, and there are no stupid questions. It is our hope that by offering some detailed information on both the RMD and the QCD, the reader will be able to cut through a little of the mumbo jumbo found in the area of IRAs. Please feel free to contact us if you have any questions or would like to discuss this matter in further detail.

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