SECURE 2.0 ACT ALLOWS A QUALIFIED CHARITABLE DISTRIBUTION FROM AN IRA TO FUND A CHARITABLE GIFT ANNUITY OR CHARITABLE REMAINDER TRUST

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SECURE 2.0 Act Allows a Qualified Charitable Distribution from an IRA to Fund a Charitable Gift Annuity or Charitable Remainder Trust

By Kaylyn Varnum, CPA; Michele Wales, CPA; & Mike Batts, CPA

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Federal tax law requires individuals who have reached a certain age to begin taking required minimum distributions (RMDs) from traditional IRAs. Generally, distributions from traditional IRAs are subject to income tax.

An opportunity has existed in the tax law for a number of years for individuals 70½ and older to make an annual tax-free qualified charitable distribution (QCD) of up to $100,000 directly from their traditional IRAs to qualified charitable organizations. (The $100,000 annual limit on QCDs is reduced by the amount of deductible retirement account contributions made after age 70½. For married individuals filing a joint return, the limit is $100,000 per IRA owner.)

The QCD benefit to the IRA owner is twofold – (1) the distribution counts toward the individual's required minimum distributions, and (2) the distribution is excluded from the retirement account owner's taxable income.

Because QCDs are not included in the individual's taxable income, the retirement account owner is not entitled to a charitable contribution deduction for QCDs.

In order to qualify as a QCD:

1. The distribution must be made on or after the date the individual owner of the retirement account turns 70½;

2. The distribution must be made to a qualifying charity (publicly supported organizations, churches, and schools are all qualifying charities, but the distribution cannot be made to a supporting organization, private non-operating foundation, or donor-advised fund);

3. The distribution must be distributed directly from the IRA to the qualifying charity;

4. The individual retirement account owner may not receive any benefits from the charity in exchange for the distribution; and

5. The individual retirement account owner must receive a proper acknowledgment from the qualifying charity.

Expansion of the QCD benefit by the SECURE 2.0 Act

The SECURE 2.0 Act makes annual inflation adjustments to the $100,000 annual limit for QCDs for tax years beginning after 2023.

Additionally, for tax years beginning after December 29, 2022, a donor can make QCDs of up to $50,000 (adjusted annually for inflation) in only one calendar year directly from his/her IRA to fund a charitable gift annuity or a charitable remainder trust.

A charitable gift annuity (CGA) is a contract between an individual and a qualified charitable organization (e.g., a publicly supported charity, school, church, or hospital) where a donor makes a gift of cash or other property to the charity in exchange for a fixed annuity payment (made at least annually) to one or two individuals for the remainder of the individuals' lives. CGAs are subject to varying degrees of regulation under state laws.

A charitable remainder trust (CRT) is a separate legal entity (a trust) that must have a trustee (which can be the donor, the charity, or a third party). The CRT is funded by the donor with cash or other property. It then pays an income stream for the donor's life or for a period of time to one or more income beneficiaries, with the remainder of the trust's assets going to one or more charitable beneficiaries. The donor typically receives a charitable deduction for the present value of the remainder interest, subject to certain limitations. There are two main types of CRTs – a charitable remainder annuity trust (CRAT) (which pays a fixed amount at least annually to the income beneficiary(ies) based on a percentage of the initial value of the assets contributed to the trust) and a charitable remainder unitrust (CRUT) (which pays a variable amount at least annually to the income

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beneficiary(ies) based on a percentage of the annual value of the trust's assets). Both CRATs and CRUTs are eligible CRTs for purposes of the QCD expansion rules included in the SECURE 2.0 Act.

In order to qualify as a QCD to a CGA or CRT:

1. The distribution must otherwise meet the general requirements for QCDs outlined above (other than the direct transfer to a qualifying charity);

2. The distribution must be made to a CGA or CRT that is exclusively funded by the QCD (pre-existing CGAs and CRTs are not eligible recipients of a QCD);

3. The CGA or CRT income interest can only be paid to the donor and/or the donor's spouse and cannot be assignable;

4. In the context of a distribution to a CGA, the entire distribution reduced by the value of the annuity must otherwise meet the criteria for deductibility as if the contribution were not made from an IRA;

5. In the context of a distribution to a CRT, the entire remainder interest in the distribution to a CRT must otherwise meet the criteria for deductibility as if the contribution were not made from an IRA; and

6. In the context of a distribution to a CGA, the CGA annuity payments must begin no later than one year after funding, and the payments must be at a fixed rate of 5% or greater.

The new law also clarifies that the income interest received from a CRT that was funded by a QCD is treated as ordinary income to the recipient, regardless of the nature of the income (this differs from the typical rules for distributions from CRTs).

While not completely clear, it appears that the one-calendar-year QCD to a CRT or CGA (limited to $50,000 in 2023 and inflation-adjusted in subsequent years) is counted as part of the $100,000 annual limit (also inflation-adjusted after 2023) for all QCDs made during the year. We expect that the IRS will release guidance in the future that clarifies this point.

Practical Observations

First, in light of the one-calendar-year $50,000 limit on these new types of QCDs, and given the administrative complexities and costs involved in ensuring compliance with state laws regarding CGAs or in establishing and administering a CRT, it is likely that these new types of QCDs will have limited appeal to donors and charities.

CRTs, in particular, are likely to be unattractive targets for QCDs due to the combination of the dollar limit and the requirement to file annual federal tax returns – a significant and costly administrative burden.

Additionally, other provisions of the SECURE 2.0 Act may have the effect of reducing the attractiveness of QCDs for certain individuals. Specifically, the age for which minimum distributions from an IRA are required was raised as a part of the original SECURE Act in 2019 and was raised again as a part of the SECURE 2.0 Act in 2022. See the chart below for the beginning date of required minimum distributions under the current law.

Date of Birth	**Beginning age for RMDs**
June 30, 1949, and prior	70½
June 1, 1949 – December 31, 1950	72
January 1, 1951 – December 31, 1959	73
January 1, 1960, and thereafter	75

The SECURE 2.0 Act also reduced the penalty for failure to make required minimum distributions from 50% to 25%. If the failure is corrected in a timely manner, the penalty may be further reduced to 10%.

Concluding Comments

Notwithstanding the limitations of the appeal of QCDS to fund CGAs or CRTs noted above, charities should be aware of these new opportunities and

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consider whether the organization's donors may be interested in pursuing these benefits. A charity that is interested in making these charitable opportunities available to their donors without directly handling the administrative burden of establishing the CRTs or CGAs may wish to consider outsourcing the administration to third parties.

There is also a brief video clip of the discussion of this topic at the 2023 BMWL National Nonprofit Conference available on our website.[1]

BMWL Can Help

As always, if you would like assistance addressing the information described in this alert, we would be glad to help! Please email our team at Info@NonprofitCPA.com.

[1] Source: https://nonprofitcpa.com/secure-2-0-act-allows-a-qualified-charitable-distribution-from-an-ira-to-fund-a-charitable-gift-annuity-or-charitable-remainder-trust/

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