Morgan Stanley

Morgan Stanley Global Impact Funding Trust

The IRA Qualified Charitable Distribution

The U.S. tax laws permit, and in fact encourage, individuals to save for retirement through tax-deferred investment accounts known as "individual retirement accounts," or "IRAs." One of the benefits of contributing to an IRA is that contributions to the account maintain tax free growth potential—the owner of the IRA is generally not taxable on any interest, dividends, or earnings that accrue while funds are held in the account.

There are two types of IRAs to which individuals may make personal contributions: a "traditional IRA" and a "Roth IRA." In a traditional IRA, an individual, if eligible, may contribute pre-tax dollars (i.e., funds for which the IRA owner will receive a current income tax deduction for making the contribution), but will be taxed when distributions come out of the account. In a Roth IRA, an individual contributes post-tax dollars (i.e., funds for which the Roth IRA owner will not receive a current income tax deduction), but does not pay tax on either the income from the investments while they are in the account or on subsequent distributions from the account as long as it is a qualified distribution (i.e., the distribution occurs after the owner has had the Roth IRA for five years, is made on or after the owner turns 59½, and is made due to the owner's death or disability, or for the owner's first-time home purchase, up to a $10,000 lifetime maximum).

The amount of money that an individual can contribute to an IRA in any one calendar year is limited; the maximum contribution limit applies to all of your IRAs combined. The amount is determined each year by the Internal Revenue Service and is generally published in October of each year for the following year.

Generally speaking, contributions to IRAs are irrevocable, and early withdrawals of funds from an IRA can be subject to the 10% premature penalty tax if the withdrawal occurs before the owner of the account reaches the age of 59½. However, the owner of a traditional IRA must begin taking "required minimum distributions," also known as "RMDs," once he or she reaches age 70½. As the name suggests, an RMD is the minimum amount by law that an individual must withdraw from his or her traditional IRAs in a given year. The amount of an individual's RMD is calculated based on specific federal tax rules. Roth IRAs are not subject to the same minimum distribution rules as a traditional IRA during the lifetime of the account owner (i.e., the person who contributed to the account). However, the beneficiary of a Roth IRA is subject to RMD rules when the Roth IRA owner dies.

QUALIFIED CHARITABLE DISTRIBUTIONS

Prior to 2006, individuals who were charitable and wanted to use funds held in an IRA to fund charitable gifts were required to first take a distribution from the account, thereby causing the entire taxable portion of the distribution to be treated as income for income tax purposes, and then make the charitable gift. While a donor would typically receive a charitable deduction for the amount of the charitable gift, there were many circumstances where the donor was unable to completely offset the income received from the IRA distribution with the charitable deduction.

In 2006, Congress introduced (on a temporary basis) the Qualified Charitable Distribution (QCD) provision for IRA holders. In a QCD, an individual over age 70½ can fund gifts to charities from his or her IRA (other than ongoing SIMPLE and SEP IRAs). Specifically, an individual can make one or more "qualified charitable distributions" from his or her IRA, up to an aggregate of $100,000 during the year, directly to certain qualified charities of his or her choice. To qualify, the distribution was required to be paid directly from the IRA to the qualified charity. The QCD became permanent in 2015.

Distributions that qualify as a QCD receive very favorable tax treatment: they are not included in the individual's gross income, but nonetheless count toward the RMD that the IRA owner must otherwise take each year after reaching age 70½ (or a beneficiary must take after the death of the IRA owner). The distribution to charity does not reduce the amount the donor can otherwise give to charity on a fully deductible basis. In other words, the amount donated through the QCD will not "count" as a charitable donation when calculating the donor's charitable gifts for the year. Thus, while the donor does not have income from the distribution, the donor does not receive a charitable deduction either.

Below is a hypothetical illustration of how the QCD works and the tax savings it may offer:

Mary is 74 years old and is charitably-minded. Her RMD for her three traditional IRAs for 2019 is $100,000 in the aggregate. She has $300,000 of income from other sources and does not need the full amount of her RMD to pay her day-to-day living expenses. She is considering whether a QCD of the full amount of her RMD is right for her.

SCENARIO 1: MARY TAKES HER RMD INTO INCOME, THEN CONTRIBUTES IT TO CHARITY		**SCENARIO 2: MARY MAKES A QCD EQUAL TO HER RMD**	
Mary's Non-IRA Income	$300,000	Mary's Non-IRA Income	$300,000
Mary's RMD — No QCD	$100,000	Mary's RMD as a QCD	$ 0
Mary's Adjusted Gross Income	$400,000	Mary's Adjusted Gross Income	$300,000
Less: Charitable Deduction	($100,000)	Less: Standard Deduction	($12,000)
Mary's Taxable Income	$300,000	Mary's Taxable Income	$288,000
Mary's Total Tax	$80,194	Mary's Total Tax	$75,924
		Mary's Tax Savings from the QCD	**$4,270**

Unfortunately, under current law, gifts to donor advised funds (DAFs), private nonoperating foundations and supporting organizations are not eligible for QCD treatment. Individuals who wish to do so still may make gifts to DAF accounts using funds held in an IRA by withdrawing funds from the IRA and then contributing the amount to a DAF account. The taxable portion of the funds withdrawn from the IRA is included in the individual's gross income, and the amount is eligible for an income tax deduction to the extent permitted by law. While there have been proposals to extend the benefits of the QCD to include donor advised funds, as of this writing, none are actively being advanced by Congress.

Before making any charitable gift, it is advisable to consult with experienced financial and tax professionals who can work with you to help you achieve your goals and objectives.

[1] While beyond the scope of this article, income tax deductions for charitable gifts are subject to a variety of limitations. For more information, please refer to our publication entitled "2019 Charitable Giving Review."

[2] For simplicity's sake, this analysis assumes that Mary is a single-filer, that her $300,000 of non-IRA income is taxable at ordinary income rates, and that her only itemized deduction is her charitable contribution of $100,000 in the amount of her RMD. Tax liabilities calculated in the examples are based on the marginal rates that became effective on January 1, 2019. The hypothetical example does not include state or local taxes.

CRC 2536072 06/19 CS 9331267 06/19