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Retirement Planning

For Qualified Charitable Distributions, Timing Is Everything

Careful planning can help maximize tax benefits from Qualified Charitable Distributions, which are tax-free withdrawals from IRAs earmarked for qualifying charities.

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This is an update of one of our most-requested articles, previously published in November 2023.

Qualified Charitable Distributions (QCD) first became available in 2006 as part of the Pension Protection Act, with an expiration date of December 31, 2007. The deadline, however, was extended several times and finally became permanent as Congress included it in the Consolidated Appropriations Act of 2016. Secure Act 2.0 passed in late 2022 made two significant changes to the QCD rules.

As a refresher, a Qualified Charitable Distribution is a tax-free withdrawal from an Individual Retirement Account (IRA) made directly to a qualifying charity. It serves as a popular way to do good while also satisfying the IRA holder's required minimum distribution (RMD). Although not eligible for a charitable deduction, a QCD is not included in the IRA owner's adjusted gross income (AGI) under IRS rules. Leveraging a QCD to lower one's AGI could potentially reduce those taxes based on income, such as Social Security benefits or Medicare Parts B and D premium surcharges (known as Income Related Monthly Adjustment Amount or IRMAA). Available to owners and beneficiaries age 70½ or older, a QCD offers tax-free IRA distributions of up to $108,000 in 2025.

Here, we discuss the importance of coordinating a RMD with a QCD to help maximize tax benefits, Secure Act. 2.0 changes, and other guidelines you need be familiar with when seeking tax-free QCD treatment.

First-Dollars-Out Rule

RMDs begin for an IRA owner (excluding a Roth IRA) in the year they reach age 73. For an IRA owner with charitable intentions, a potentially substantial tax benefit becomes available when a QCD is used. A QCD can reduce or even eliminate the income tax ordinarily due on RMD income. Notably, QCDs can start as early as 70½ (the account owner's 70½ birthday), even though minimum distributions aren't required until age 73.

But ... timing is everything. To ensure you receive the QCD tax benefit, an individual must coordinate their QCD with their RMD, or the QCD may be treated as taxable income. Why? *The first dollars withdrawn from an IRA in any year (an owner is subject to an RMD) are deemed to satisfy the RMD.* This is referred to as the "first-dollars-out" rule, and that, in turn, creates a timing oddity for QCDs.

Coordinate the Timing to Properly Execute a QCD

Many IRA owners like to get their RMD out of the way by taking it early in the year or making systematic distributions (i.e., monthly, quarterly, etc.). However, those individuals who want to reduce their RMD income should *first* make a QCD directly from their IRA to a qualifying charity, then take their annual RMD. We therefore suggest making a QCD early in the year to avoid any conflict with the first-dollars-out rule.

For an IRA owner who is looking to offset the income from a RMD with a QCD, those transactions must be done in conjunction with each other. In other words, an IRA owner cannot take their RMD and then decide to retroactively do a QCD with those same dollars. Notably, a QCD can be done after an RMD is taken, but the QCD will be an additional distribution on top of the RMD.

To illustrate this point using a hypothetical example, here is an all-too-common scenario where a QCD can become a taxable distribution:

EXAMPLE:

- Tanya, age 75, took an RMD of $5,000 from her traditional IRA in January 2025.
- In December 2025, Tanya takes another $5,000 distribution, thinking it will qualify as a QCD and offset (it doesn't) the income from the previous ($5,000) distribution she took in January.

In conclusion, Taya withdrew a total of $10,000 from her traditional IRA, $5,000 of which is current taxable income because her RMD was taken *before* the QCD and thus subject to the "first-dollars-out" rule. Whereas the $5,000 distribution taken in December was transferred directly to a qualifying charity and qualifies as a QCD and thus excluded from taxable income.

What Tanya should have done:

- Tanya's $5,000 distribution in January should have been transferred directly to a qualifying charity prior to taking her 2025 RMD. Why? By doing it this way, the $5,000 QCD would have satisfied her 2025 RMD, so no additional funds would need to be distributed from her IRA. Furthermore, Tanya would have withdrawn a total of $5,000 (as opposed to $10,000), and the distribution would have been completely tax free because it's eligible for QCD treatment.

QCDs can be done at any time during the calendar year and can also be done after all or a portion of the RMD has already been taken. The only reason it is suggested to do QCDs early is to avoid what Tanya did—*mistakenly take a taxable distribution that cannot be retroactively offset with a future QCD*!

PRACTICE TIP: QCDs for those individuals age 70½ or older are only permitted from IRAs (including an inherited IRA). QCDs cannot be done from an employer-sponsored retirement plan (i.e., 401(k), 403(b), 457(b), etc.).

Secure Act 2.0: New Rules for Qualified Charitable Distributions

Secure Act 2.0 enacted two new rules affecting QCDs. These changes are as follows:

1. **Maximum Annual QCD Amount Indexed for Inflation.** QCD's limit has remained at $100,000 (annually) since its inception in 2006. Beginning in 2024, the limit is now linked to the rate of inflation. The 2025 QCD limit is $108,000.
2. **One-Time Opportunity to Fund a Split-Interest Entity.** Beginning in 2023, account holders were offered a *once-in-a-lifetime opportunity* to use a QCD to fund a Charitable Remainder Unitrust (CRUT), Charitable Remainder Annuity Trust (CRAT), or Charitable Gift Annuity (CGA).

The maximum (lifetime) distribution amount is $54,000 in 2025. This provision essentially allows a traditional IRA owner to move funds (to a split-interest entity) free of income or estate tax to future generations. However, it's not that simple. There are several hurdles that must be satisfied before the individual can reap the tax benefits of such a transaction. We urge you to discuss this new opportunity with your financial and or tax professional.

QCD Tax Traps

- To receive QCD treatment, a distribution of IRA funds must be done as a *direct* transfer to a qualifying charity.
- Donor-advised funds and private foundations do *not* qualify for QCD treatment.
- A QCD is a tax-free transfer from an IRA to a qualifying charity. However, a QCD is generally reported on IRS Form 1099-R *"Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc." as a normal IRA distribution* and thus included in taxable income. In other words, the 1099-R will not indicate the distribution is a QCD and therefore a non-taxable transaction. An IRA owner (or their beneficiary) must advise their tax professional to ensure the QCD tax benefit is received.
- The SECURE Act of 2019 removed the 70½ age limitation for contributing to a traditional IRA. Thus, an eligible individual with earned income, regardless of age, can now contribute to a traditional IRA. However, if you are 70½ or older and make a *deductible*, traditional IRA contribution, any subsequent QCD (up to the amount of the deductible contribution) will be taxable.
- A QCD can only be done for the current calendar year; for example, a QCD for 2025 must be *completed* by December 31, 2025. If the deadline is missed, you can't make a QCD for the prior tax year.
- A tax deduction cannot be taken for the charitable contribution, and nothing can be received in return for the donation.
- Itemization is not required to make a QCD.
- A QCD must consist of only pre-tax IRA funds. This raises the question: "How do I qualify for QCD treatment if any of my IRAs contain 'basis '(after-tax dollars)?" QCDs are an *exception* to the IRS pro-rata distribution rule. QCDs are distributed from pre-tax funds first!
- Roth IRAs are generally not QCD-eligible because qualified Roth IRA distributions are tax-free. Thus, QCDs can be made from a Roth IRA *only* if the account owner had *not* satisfied the requirements for a "qualified distribution."[1]

A Final Word

A Qualified Charitable Distribution provides an opportunity for IRA owners to "give something back" from a lifetime of savings while also reducing their AGI. With proper foresight, and a careful eye on distribution planning, a QCD can be a "win-win," both for an account holder looking for a smart tax-planning strategy and the qualifying charity that stands to benefit.

Questions? Please contact your Lord Abbett representative at 888-522-2388.

[1]Source: irs.gov, as of September 10, 2024. A qualified distribution is any payment or distribution from your Roth IRA that meets the following requirements: (1) It is made after the five-year period, beginning with the first tax year for which a contribution was made to a Roth IRA set up for your benefit; and (2) the payment or distribution is (i) made on or after the date you reach age 59½; (ii) made because you are disabled; (iii) made to a beneficiary or to your estate after your death; or (iv) meets the requirements for a first home purchase (up to a $10,000 lifetime limit).

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A Traditional IRA is an individual retirement account (IRA) that allows individuals to direct income, up to specific annual limits, toward investments that accumulate tax-deferred. Contributions to the traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and other factors.

A SIMPLE IRA is a retirement plan that may be established by employers, including self-employed individuals. The employer is allowed a tax deduction for contributions made to the SIMPLE. The employer makes either matching or nonelective contributions to each eligible employee's SIMPLE IRA, and employees may make salary deferral contributions.

A Roth IRA is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years, and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax-deductible, but withdrawals during retirement are generally tax-free.

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