IRAs and Qualified Charitable Distributions

- By Chris Brennan, CFP®

There have been many discussions throughout the last eight months about the impact of the Tax Cut and Jobs Act (TCJA) that took effect on January 1st. Most taxpayers are now aware of some of the more impactful changes, namely the deductibility of state and local taxes as well as the doubling (effectively) of the standard deduction.

In previous articles, we have identified actions taxpayers can take to reduce the impact of the TCJA. This article[1] (see link at end of article) discussed the idea of bunching deductions (namely charitable contributions) and the beneficial impact it can have on taxes paid to the IRS.

Another strategy to mitigate the potential lost tax benefit of charitable contributions revolves around required minimum distributions (RMDs). RMDs are required by the IRS in the year in which an IRA (or in some cases a 401(k)) owner reaches the age of 70.5, and every year thereafter. The IRS requires that an IRA owner distribute a portion (a little less than 4% at age 70.5) of their IRA at this point in time; and if the distribution isn't made, the penalty can be particularly onerous. RMDs are also required by the IRS in the year following (and every year thereafter) the year in which an individual inherits an IRA. The amount of the RMD is dependent upon the account value and the age of the beneficiary. Younger beneficiaries are subject to smaller RMDs while older beneficiaries are subject to larger RMDs.

So, what does all of this have to do with the TCJA and charitable deductions? As alluded to above, the standard deduction essentially doubled for everyone. A married couple that would have been entitled to a standard deduction of $12,700 in 2017 is now entitled to a standard deduction of $24,000 in 2018. The result? A lot less taxpayers will be itemizing their deductions. Further, a lot less taxpayers will be benefitting from charitable contributions. And even though the tax deduction is not the primary motivator behind giving, it has been a nice "plus" for a long time. But for many taxpayers going forward, there will be no charitable deduction. Enter the qualified charitable distribution (QCD).

QCDs are qualified charitable distributions made directly from an IRA to a charitable institution (must be 501(c)3). Further, QCDs can be made with RMD dollars; in which case the IRA owner never takes possession of the dollars, and therefore the dollars are not recognized on their tax return. So effectively they're getting a charitable deduction for a contribution they would have made anyways. Let's look at an example:

Jane Doe has a $7,000 RMD in 2018. John and Jane Doe are retired and live in Florida. They're currently renting so they don't pay property taxes, and they obviously don't pay any mortgage interest. Their charitable giving amounts to (coincidentally) $7,000/year, and all of it goes to their church. With so few itemized deductions, they're very likely to claim the standard deduction in 2018. They can do one of two things now:

- Take the RMD ($7,000) and deposit it into their bank account before sending a check to their church at the end of the year. The RMD amount will be recognized as income in 2018 and because they're not itemizing they won't have a charitable deduction.
- Make a QCD ($7,000) with their church identified as the recipient at the end of the year. The RMD amount will not be recognized as income and because they're not itemizing, they won't be missing out on a tax deduction for the charitable contribution.

QCDs are only available to IRA owners who are age 70.5 and older. Also, QCDs are capped at $100,000 per person, per year (so spouses can do as much as $200,000/year).

We realize this article doesn't apply to everyone, but we are cognizant of taxpayers' desire to identify ways in which they might be able to limit the impact of the new tax laws. We encourage you to reach out to us with any questions you may have, and recommend you put this in front of friends or family who may be in their 70s and 80s with charitable inclinations.

[1] http://www.jdovich.com/wp-content/uploads/2018/01/Tax-Reform-Article.1.2018.pdf

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