From the desk of
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Charitable Giving Alternatives through a Qualified Charitable Distribution

The Tax Cuts and Jobs Act (TCJA) has changed the landscape for many taxpayers, with many taxpayers with lower itemized deductions now facing the possibility of losing their charitable deductions.

This is not good news for those who are charitable givers, but those who are age 70½ or older can continue to gain a tax benefit from their charitable contributions even if they do not itemize.

The key is to make the gift by way of a qualified charitable distribution (QCD).

Charitable contributions may still be claimed as an itemized deduction but the TCJA restricted itemized deductions for state and local income and property tax, tinkered with the deduction for residence interest (by reducing the dollar limit on acquisition debt and eliminating the deduction for interest on home equity debt), as well as did away with miscellaneous itemized deductions.

The tax act also nearly doubled the standard deduction.

The net result is that charitable contributions will in many instances not yield any tax benefit for the many millions more Americans who will no longer itemize their deductions.

But there is a way to get around this issue for older individuals, specifically for those who are age 70½ or older and are receiving required minimum distributions (RMDs) from IRAs to come out ahead when they make a charitable contribution.

The key is to make annual contributions by way of qualified charitable distribution from their IRAs and thereby reduce the taxable RMDs by the amount donated in that manner.

Required minimum distributions (RMD)

Taxpayers must start taking annual RMDs from their traditional IRAs by April 1 following the year in which they attain age 70½.

Failure to withdraw the annual RMD could expose the taxpayer to a penalty tax equal to 50% of the excess of the amount that should have been withdrawn over the amount actually withdrawn.

The first distribution year is the year in which the IRA owner attains age 70½, but that first distribution may be postponed until the second distribution year.

The amount of each RMD is calculated separately for each IRA, however the RMD amounts for the separate IRAs may be totaled and the aggregated RMD amount may be paid out from any one or more of the IRA accounts.

Each year's RMD is determined by a table percentage that varies with the taxpayer's age and is applied against to the total IRA balance at the end of the preceding year.

Qualified charitable distributions (QCD)

An annual exclusion from gross income (not to exceed $100,000) is available for otherwise taxable IRA distributions that are QCDs.

Such distributions are not included in gross income, and cannot be claimed as a deduction on the taxpayer's return.

The donation to a QCD is not subject to the general percentage limitations that apply for making charitable contributions.

Even though a QCD from an IRA to a charity is not included in the taxpayer's gross income it is taken into account in determining the owner's RMD for the year.

A qualified charitable distribution is one that is made

1. On or after the IRA owner attained age 70½ and
2. Directly by the IRA trustee to a Code Sec. 170(b)(1)(A) charitable organization (other than a Code Sec. 509(a)(3) organization or a donor advised fund.

Also to be excludable from gross income the distribution must be otherwise entirely deductible as a charitable contribution deduction under Code Sec. 170 without regard to the regular charitable deduction percentage limits.

Recommendation

Using qualified charitable distributions instead of making charitable gifts from other sources can result in meaningful tax savings for charitable-minded taxpayers who are receiving RMDs and will not itemize their deductions.

For 2018 that will be the case if total itemized deductions including charitable contribution deductions will not exceed $24,000 for joint filers, $18,000 for heads of household, and $12,000 for single filers (plus $1,300 for the elderly or blind, or $1,600 for a taxpayer who is unmarried and not a surviving spouse).

Taxpayers interested in utilizing a QCD to reduce their tax bills should defer taking RMDs or defer taking the entire amount of the RMD until near the end of the year or whenever else in the year that they know how much they will contribute to charity for the year. By doing so, they can know before taking any actual IRA distributions how much their RMD (and AGI, and taxable income) can be reduced by making QCDs for the year.

A QCD must be made directly by the IRA trustee to a charitable organization, thus a distribution made to an individual, and then rolled over to a charitable organization is not excludable from gross income.

If a check from an IRA is made payable to a charitable organization and delivered by the IRA owner to that organization then the payment to the organization is treated as a direct payment made by the IRA trustee to the organization.

The strategy work for itemizers as well.

Taxpayers if the age-70½-or-older taxpayer who have high medical expenses should consider this approach as well in that the use of a QCD reduces the taxpayer's Adjusted Gross Income (AGI) which can qualify the taxpayer for a higher medical expense deduction being that a lower AGI allows for a higher medical expense after the required exclusion.

Under the TCJA medical expenses can be claimed as an itemized deduction for 2018 only to the extent they exceed 7.5% of AGI (above 10% of AGI for 2019 and later).

Additionally the reduced AGI may help avoid or mitigate the effect of the 3.8% surtax on net investment income.

This surtax is levied on the lesser of

1. Net investment income or
2. The excess of modified AGI over the threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for marrieds filing separately, and $200,000 for other taxpayers).

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