Op-Ed: Lowering taxes with QCDs

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You may have heard that that IRS requires individuals over the age of 70 ½ to begin taking distributions on their tax-deferred retirement accounts, forcing them to pay taxes on a portion of their IRAs, 401(k)s, etc. during their lifetime. These distributions are referred to as Required Minimum Distributions, or RMDs.

The problem for those over 70 1/2 is that these additional distributions can cause you to pay more taxes and could even push you into a higher tax bracket. So, is it possible to prevent the additional tax? One way any taxpayer can lower their taxes is to increase their itemized deductions on their tax return, but that's not as easy as it once was.

Prior to the Tax Cuts and Jobs Act of 2017, the standard deduction was $6,350 for an individual and $12,700 for a married couple filing jointly.[1] For those that made notable charitable contributions, it was more common to surpass those standard deduction amounts, allowing those givers to itemize their deductions.

However, with the passing of the TCJA of 2017, the standard deduction amounts today ($12,000 for an individual and $24,000 for a married couple) make it much more difficult for itemized deductions that surpass these higher marks.[2] This may cause those that are charitably inclined to lose the tax benefits of making those donations. But, with the use of Qualified Charitable Distributions (QCD), they may be able to capture the tax benefits back.

What is a QCD?

A QCD is a direct transfer of funds from an IRA custodian, payable to a qualified charity, as described in the QCD Provision of the Internal Revenue Code.[3] But, why is this even a big deal? The beauty of a QCD is that it allows you to take the standard deduction, but still get credit for your charitable contributions, which would ultimately lower your taxable income, and lower your taxes.

What are the Rules?

Like any other favorable tax break out there, it comes with rules and restrictions that need to be followed. They are:[3, 4]

- You must be at least 70 ½ years old at the time you request a QCD
- QCDs carry the same deadline as RMDs, which is generally December 31st of each year
- Distributions must go directly from the custodian to a qualified charity, meaning that checks need to be made payable to the charity, not to you, the IRA owner
- Distributions must come from an IRA and not from a 401k (SEP and SIMPLE IRAs only allowed if they are not active and receiving employer contributions)
- The maximum QCD allowable is $100,000 per year, per individual. Married couples may each make a QCD up to $100,000 from their IRAs
- Certain charities are not approved for QCDs, so it's important to work directly with your advisor and accountant to ensure the charity you have in mind is a qualified charity
- The IRA owner cannot receive any benefit or "kickbacks" as a result of the distribution

Example Scenarios

To better understand how a QCD may benefit you, let's look at a couple example scenarios.

First, let's say Mary is required to take a required minimum distribution totaling $10,000. Let's also assume that even though Mary gives to charity each year, her itemized deductions will still not exceed the standard deduction amount. Therefore, Mary will take the standard deduction on her tax return. If Mary takes the entire RMD, pays taxes on the full distribution, and then gives to charity, she will essentially not get any reduction in taxable income as a result of the charitable donation.

However, if Mary usually gives $6,000 to charity, for example, she can make that $6,000 a Qualified Charitable Distribution by sending it directly to the charity she's donating to. The rest of her RMD can simply be distributed directly to her. In this example, she'll only be taxed on the remaining RMD amount of $4,000. This will lower her taxable income and cause her to pay less in income tax for the year. If her effective tax rate is 15%, then that would be a savings of $900 for that year.

This strategy can also work for those that give large amounts to charity. For example, if Bob donates $50,000 to charity each year, he would clearly exceed the standard deduction amount of $12,000 based on his charitable donations alone. However, Bob also has the option to take the standard deduction, and then reduce his income by another $50,000 through the use of QCDs, reducing his income by a total of $62,000 for the year.

These are just simple examples of how a QCD could potentially benefit you based on your individual situation. It may be worth talking with your investment advisor and tax advisor to see if a QCD would be a beneficial strategy for you.

Bottom Line

In a post-tax reform world, it seems to be more difficult to lower your taxes by itemizing. Qualified Charitable Distributions are one additional way to lower taxes.

However, QCDs are not new. The rules permitting a Qualified Charitable Distribution (QCD) were initially created under Section 1201 of the Pension Protection Act of 2006.[4] However, these rules were only in effect for two years, and this popular provision began a pattern of going into effect, then lapsing, then going into effect again. It wasn't until the PATH Act of 2015, that the QCD became a permanent part of the IRS tax code.[4]

One final key to remember is to be sure you carefully understand the rules regarding QCDs so that you're able to take advantage of the tax benefits offered. Also, it's always important to keep detailed records of all your giving history. You should be able to obtain that information from each charity you donate to.

[1]*Publication 501 (2017, Exemptions, Standard Deduction, and Filing Information.*
https://www.irs.gov/publications/p501#en_US_2017_publink1000289299

[2] *Steps to Get a Jump on Next Year's Taxes*. https://www.irs.gov/individuals/steps-to-take-now-to-get-a-jump-on-next-years-taxes

[3]*Donating to a charity using a qualified charitable distribution (QCD)*. https://www.fidelity.com/learning-center/personal-finance/retirement/qcds-the-basics

[4]*Rules And Requirements For Doing A Qualified Charitable Distribution (QCD) From An IRA*. https://www.kitces.com/blog/qualified-charitable-distribution-qcd-from-ira-to-satisfy-rmd-rules-and-requirements/