RAYMOND JAMES

Tax planning with qualified charitable distributions

Understand how to benefit from this tax-saving tool

GIVING WITH GREATER BENEFITS

Are you 70 ½ or older and do you have an IRA? Do you have charitable intentions for your current or future required distributions? Consider the use of a qualified charitable distribution (QCD).

With QCDs, an IRA owner or beneficiary over age 70 1/2 can donate up to $105,000 directly from an IRA to a charity without getting taxed on the distribution. A QCD can be used to satisfy part or all of your required minimum distribution (RMD) up to the QCD limit of $105,000.

Donating IRA funds directly to qualified charities allows the IRA owner or beneficiary to avoid taking possession of the funds and the tax bill that comes with it. Another benefit of the QCD is potentially reducing taxation of other sources of income, such as Social Security and the Medicare net investment income tax, while also potentially reducing Medicare Part B and D premiums.

IMPORTANT FACTORS

- *A QCD can be used to meet your required minimum distribution.*
- *Your $100,000 distribution limit can include amounts in excess of the RMD payment; however, the total annual amount cannot exceed $105,000 per person.*
- *If an RMD payment has already been made for the year, it's considered an irrevocable taxable distribution that can't be reclassified or reapplied as a QCD.*
- *A QCD is available to both IRA account owners and IRA beneficiaries, provided they are at least age 70 1/2.*
- *With QCDs, the variety of eligible charitable entities is limited to primarily public charities.*
- *A QCD is not available from a simplified employee pension (SEP) or SIMPLE IRA – accounts still receiving ongoing employer contributions.*
- *While a QCD can be done from a Roth IRA, this generally isn't advisable given that there is no RMD requirement from Roth IRAs. Furthermore, qualified distributions from Roth accounts are tax-free so there is no tax benefit to making a QCD.*
- *Normally, if you have made after-tax contributions to one or more IRAs, the pro-rata rule applies (meaning part of the distribution is taxable and part nontaxable). With a QCD, your taxable contributions are distributed first. The QCD avoids the pro-rata rule.*

HOW IT WORKS

The QCD must be paid directly to the charity, which must be a qualified 501(c)(3) institution eligible to receive tax-deductible contributions. A QCD cannot be made to a private foundation, donor advised fund or supporting organization (as described in IRC 509(a)(3)). However, SECURE 2.0 Act of 2022 allows a QCD to be directed to a split interest entity such as a charitable gift annuity or charitable remainder trust provided several conditions are met (not discussed here).

The charitable entity, as the recipient of the QCD, must receive the donation by December 31 in order to ensure tax reporting for the proper year.

COMPARING THE BENEFITS OF QCD AND NON-QCD STRATEGIES

Aside from the philanthropic benefits, another benefit of charitable giving is the ability to deduct the contribution and reduce your taxable income. However, in order to deduct the contribution, a taxpayer must itemize deductions on their tax return, rather than use the standard deduction. If all itemized deductions (including the charitable gift) don't exceed the standard deduction, there is little tax benefit to making a gift. Furthermore, while a gift of cash is fully deductible, it can only be applied up to 60% of a taxpayer's adjusted gross income for the year. Any portion of the gift that cannot be applied in the current tax year can be carried forward five years to offset future income.

With a QCD, an IRA distribution that would normally be taxed at ordinary rates is directed to the charity without any associated tax liability to the IRA owner. One advantage of a QCD is that you don't have to itemize deductions on your tax return for it to be excluded from income; however, you could still do a QCD and itemize deductions for further tax savings. An additional benefit of a QCD is that you don't have to be concerned about AGI constraints – the full amount up to $100,000 is excluded from income. A QCD can also potentially reduce other areas of taxation, such as the amount of your Social Security benefit that is taxed, medical net investment income tax, and Medicare premium surcharges.

How to file taxes with a QCD

Your 1099-R form will show the distributed amount for the calendar year when your withdrawal is made with no code indicating a QCD. Therefore, when filing:

- List the QCD amount on the 1040 tax form on the line designated for IRA distributions.
- On the line for the taxable amount, enter zero if the full amount was a qualified charitable distribution.
- Enter "QCD" next to this line. See the Form 1040 instructions for additional information.

We recommend seeking guidance from your tax professional.

QCD AND THE SECURE ACT – SPECIAL CONSIDERATION

The SECURE Act, passed in late 2019, repealed age restrictions on deductible IRA contributions for individuals over age 70 1/2. With the removal of the age cap on IRA contributions, an individual over 70 1/2 who was required to take an RMD could now make a tax deductible IRA contribution (if eligible) in addition to a QCD to satisfy the year's RMD. To prevent this "double dipping," legislators included a provision in the SECURE Act that requires individuals who make both post-70.5 deductible IRA contributions and QCDs to include in their taxable income the amount of the QCD up to the total value of the deductible contribution.

Example:

When Jane was 71 and still working, she made a deductible IRA contribution of $7,000. Jane turns 72 in 2022 and her RMD for the year is $20,000. Jane is charitably inclined and makes a QCD of $20,000 to her favorite charity. The full $20,000 goes to the charity; however, the amount of pretax contributions to her IRA after age 70.5 ($7,000) will be included in her gross income for the year.

Employer contributions to a SEP IRA or SIMPLE IRA will *not* have this effect of reducing the QCD income exclusion cap.

NEXT STEPS

Since each individual's situation is unique, it's important to seek guidance from your financial advisor and tax professional to explore if this tax-planning tool can maximize your tax savings. Begin the process by meeting with your financial advisor, who will take a comprehensive look at your situation in the context of your overall financial plan. Your financial advisor has the tools, resources and expertise to help you understand if this tax planning tool may be right for you. If you have considered donating all or part of your IRA required minimum distribution payment to charity, then take action before year-end.

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