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

Although QCD has been around for nearly a decade, it was not made permanent until 2015 when Congress passed the Protecting Americans from Tax Hikes (PATH) Act. This means an IRA owner over age 70 ½ can donate up to $100,000 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 RMD up to the QCD limit of $100,000.

Donating IRA funds directly to qualified charities allows the IRA holder 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 such as Social Security, and net investment income, while also potentially lowering Medicare Part B and D premiums.

IMPORTANT FACTORS

- *A QCD can be used to meet your required minimum distribution.*
- *Your $100,000 contribution limit can include amounts in excess of the RMD payment; however, the total annual amount cannot exceed $100,000 per person.*
- *A QCD is available to both IRA account owners and IRA beneficiaries, provided they are at least age 70 ½. While age 70 ½ is still the trigger age for making QCDs, the SECURE Act reduces the individual's permitted tax exclusion by the amount of post-age-70 ½ deductible IRA contributions.*
- *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.*
- *With QCDs, the variety of eligible charitable entities is limited to primarily public charities.*
- *A QCD is not available to active SEP or SIMPLE IRAs – accounts still receiving ongoing employer contributions.*
- *While a QCD can be done from a Roth IRA, this generally isn't advisable given that most distributions at age 70 ½ or older will not be taxed anyway.*
- *The QCD avoids the pro-rata rule. With a QCD, your taxable distributions are distributed first. 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).*

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, like many public charities. A QCD cannot be made to a private foundation, donor-advised fund or supporting organization (as described in IRC 509(a)(3)), nor to a charitable gift annuity or a charitable remainder trust (CRT).

A qualified charitable distribution doesn't offer a split-interest opportunity, such as with charitable remainder trusts where donors receive part deduction and part income from the asset. The charitable entity, as the recipient of the QCD, must receive the donation by December 31 in order to ensure credit to the proper year.

QCD AND THE SECURE ACT

The SECURE Act, passed in late 2019, repealed age restrictions on deductible IRA contributions for individuals over age 70 ½. With the removal of the age cap on IRA contributions, an individual over 70 ½ could make a tax-deductible IRA contribution and an income, excluded QCD with the same dollars. To prevent this "double dipping," legislators included a provision in the SECURE Act that reduced any QCD by the amount of deductible IRA contributions made when age 70 ½ or older.

Example:

Jane, who is single, turns 72 in 2020. She has compensation income of $60,000 and makes a tax-deductible contribution of $7,000 to her traditional IRA for the year. 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 pre-tax contributions to her IRA after age 70 ½ ($7,000) will be included in her gross income for the year.

Contributions to a Simplified Employee Pension (SEP) IRA will NOT have this effect of reducing the QCD income exclusion cap.

COMPARING THE BENEFITS OF QCD AND NON-QCD STRATEGIES

For some individuals, it may make sense to use a mix of gifting strategies.

STRATEGY 1: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD)

With the amount paid excluded from income taxes, the QCD transfers directly from the IRA to the designated charity and the QCD amount avoids being added as taxable income on your tax return. For those in a high tax bracket, the QCD is a useful way of removing an otherwise taxable RMD payment from being added as income on your tax return.

Tax Year 2021 Standard Deduction

Filing Status	Standard Deduction
Single	$12,550
Head of Household	$18,800
Married Filing Separately	$12,550
Married Filing Jointly	$25,100

Unlike other forms of charitable giving that require you to itemize the deductions (of which one deduction is the gift) in order to deduct the contribution on your tax return, the QCD does not have to be itemized. Consequently, you can claim both the standard deduction, or itemize, and still exclude up to $100,000 of income associated with an IRA distribution. With the passage of the SECURE Act, however, IRA account owners must now reduce their intended QCDs by any contribution amounts made into their IRAs after age 70 ½.

STRATEGY 2: TRADITIONAL (NON-QCD) CHARITABLE CONTRIBUTIONS

When using a typical charitable contribution, in order to claim the charitable deduction, you must elect to itemize deductions on Schedule A of your tax return. You should consider itemizing if the total amount of your itemized deductions is more than your standard deduction amount.

When you donate cash to a public charity, you can generally deduct up to 60% (100% of cash in 2020 and 2021) of your adjusted gross income. Provided you've held them for more than a year, appreciated assets including long-term appreciated stocks and property are generally deductible at fair market value, up to 30% of your adjusted gross income.

Given that the RMD payment is taxable and increases your adjusted gross income, it can potentially impact taxation of Social Security benefits (for low income earners) and potentially increase premiums associated with Medicare Part B and D premiums (for high income earners).

One benefit of electing to itemize charitable contributions is that you have a larger universe of charitable entities to choose from. A second benefit is that other giving methods are available. For instance, contributions to donor-advised funds, split-interest trusts such as a charitable remainder trust and contributions to most forms of private foundations.

2021 Medicare Part B and Part D monthly premiums based on Modified Adjusted Gross Income

(as reported on your tax return two years ago)

Your Annual Income		Part B	Part D
Individual Tax Return	**Joint Tax Return**	**You Pay**	**You Pay**
$88,000 or less	$176,000 or less	$148.50	$0
above $88,000 up to $111,000	above $176,000 up to $222,000	$207.90	$12.30
above $111,000 up to $138,000	above $222,000 up to $276,000	$297.00	$31.80
above $138,000 up to $165,000	above $276,000 up to $330,000	$386.10	$51.20
above $165,000 and less than $500,000	above $330,000 and less than $750,000	$475.20	$70.70

The 3.8% Medicare tax on investment income can also be avoided using QCD. This tax is assessed on couples with Modified AGI over $250,000 and singles over $200,000, and the QCD can help keep a taxpayer below these thresholds.

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.

WHEN A QCD MAY NOT BE THE BEST OPTION

- Gifting highly appreciated stock in a non-retirement account has a dual benefit that the QCD does not have. It removes the gain from taxation and also provides the ability to claim a tax deduction against your income. The QCD just removes the RMD amount from taxation.
- In situations where the contribution will be made by cash or check, the QCD will come out with equal benefit. The QCD may be an effective means of reducing the tax impact of RMD payments; however, using appreciated securities is still the best option from a tax perspective.
- Also, if you are not in the best of health, and your intent is to pass the stock to a family member, it would be wise to simply allow your beneficiary to inherit the highly appreciated asset at death in order to take advantage of the step-up to Fair Market Value.

WHEN A QCD MAY BE MORE BENEFICIAL THAN DONATING APPRECIATED STOCK

- In instances where the amount of charitable contributions are proportionately higher than your Adjusted Gross Income, such that the full charitable deduction cannot be claimed in the current year or in the five years, the deduction may be carried forward.
- If your total itemized deductions don’t exceed your standard deduction, then the benefits of itemizing charitable deductions are of little use. You can either claim the standard deduction or itemize – but you can’t do both. Keep in mind that QCD is available regardless of whether you itemize or choose the standard deduction. If your donation of appreciated securities doesn’t rise to the level where they exceed the standard deduction threshold, then the value of this method of giving is limited.
- If your highly appreciated stock is held within an IRA, then any withdrawal will be taxed as ordinary income anyway, with no opportunity for capital gain treatment.

NEXT STEPS

Since each individual’s situation is unique, it’s important to seek guidance 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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