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Qualified Charitable Distributions: Using Your IRA to Give from the Heart

The Tax Cuts and Jobs Act roughly doubled the standard deduction ($12,200 for single filers and $24,400 for married taxpayers filing jointly in 2019) and indexed it for inflation through 2025. As a result, far fewer taxpayers will itemize deductions on their tax returns, and some people may be disappointed that they no longer benefit from writing off their donations.

If you are 70½ or older, you can use a qualified charitable distribution (QCD) to donate from your IRA and get a tax break, whether you itemize or not. Not coincidentally, this is the same age you must begin taking annual required minimum distributions (RMDs), which are normally taxed as ordinary income, or face a 50% penalty on the amount that should have been withdrawn.

QCDs satisfy all or part of any RMDs that you would otherwise have to take from your IRA. Better yet, QCDs are excluded from your income, so they help lower your adjusted gross income (AGI) as well.

How QCDs work

The IRA custodian must issue a check made out to a qualified public charity (not a private foundation, donor-advised fund, or supporting organization). In some cases, the IRA custodian may provide a checkbook from which you can write checks to chosen charities. Be aware that any check you write will count as a QCD for the year in which it is cashed by the charity, whereas a check from the custodian counts for the year in which it is issued.

You can take an RMD any time during the year you turn 70½, but you must wait until after you are 70½ to make a QCD. The QCD exclusion is limited to $100,000 per year. If you're married, your spouse can also contribute up to $100,000 from his or her IRA. You cannot deduct a QCD as a charitable contribution on your federal income tax return — that would be double-dipping.

A QCD must be an otherwise taxable distribution from your IRA. If you've made nondeductible contributions, then each distribution normally carries with it a pro-rata amount of taxable and nontaxable dollars. With QCDs, the pro-rata rule is ignored, and taxable dollars are treated as distributed first.

Tax perks for givers

If you no longer itemize, you could reduce your tax bill by donating with QCDs from your IRA instead of writing checks from your standard checking account. And if you still itemize, QCDs might prove more valuable than tax deductions. That's because they can help address tax issues that might be triggered by income from RMDs.

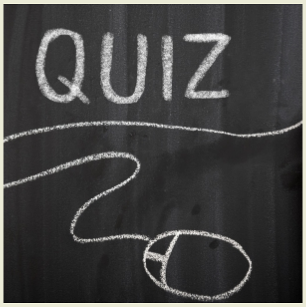
For example, an itemized deduction reduces your taxable income by the amount of the charitable gift, but it does not reduce your adjusted gross income. This is a key distinction because the 3.8% tax on net investment income, Medicare premium costs, taxes on Social Security benefits, and some tax credits are based on AGI.

Also, charitable giving can typically be deducted only if it is less than 60% of your adjusted gross income. But with QCDs, you may be able to give more than 60% of your AGI and exclude the entire amount (up to the $100,000 cap) from your taxable income.

Time for a rollover?

Qualified charitable distributions are available from traditional IRAs, Roth IRAs (with taxable amounts), and inactive SIMPLE or SEP IRAs, but they are not allowed from employer retirement plans such as 401(k)s and 403(b)s. Thus, you might consider rolling funds from an employer plan to an IRA if you want to take advantage of a giving strategy that involves QCDs.

December 2019



This quiz covers only some basic rules. For more information about other retirement earnings test rules, visit the Social Security Administration website, [ssa.gov.](ssa.gov)

Take This Quiz: The Social Security Retirement Earnings Test

Can you work and receive Social Security retirement benefits at the same time? Yes, but the Social Security Administration (SSA) will apply an earnings test. Part or all of your monthly benefit may be withheld if you earn too much.

To help avoid surprises, take this quiz to find out what you know — and don't know — about Social Security earnings test rules.

Questions

1. The retirement earnings test applies only if you are receiving Social Security benefits and are...

a. Under age 62

b. Under full retirement age

c. Full retirement age or older

d. Age 70 or older

2. Which of the following types of income count toward the earnings test?

a. Wages earned as an employee and net self-employment income

b. Pension and retirement plan income

c. Interest and dividends

d. Both a and b

e. All of the above

3. Benefits that are withheld are lost forever.

a. True

b. False

4. The earnings test may affect family members who are receiving which types of benefits?

a. Disability benefits

b. Spousal benefits

c. Dependent benefits

d. Both b and c

5. What special rule applies to earnings for one year, usually the first year you claim Social Security retirement benefits?

a. A monthly earnings limit applies to any earnings after you claim retirement benefits.

b. Earnings during the first year after you claim retirement benefits can't be counted if you retired after 40 years of continuous employment.

c. Earnings during the first year after you claim retirement benefits will not reduce your Social Security benefit if you retired from a government job.

Answers

1. b. If you have not yet reached full retirement age (66 to 67, depending on your year of birth), your Social Security retirement benefit may be reduced if you earn more than a certain annual amount.

In 2020, $1 in benefits will be deducted for every $2 you earn above $18,240. In the calendar year in which you reach your full retirement age, a higher limit applies. In 2020, $1 in benefits will be deducted for every $3 you earn above $48,600. Once you reach full retirement age, your earnings will not affect your Social Security benefit.

The SSA may withhold benefits as soon as it determines that your earnings are on track to surpass the annual limit. The estimated amount will typically be deducted from your monthly benefit in full, so you might not receive benefits for one or more months before they resume.

2. a. Only earned income, such as wages from an employer and net self-employment income, count toward the earnings limit. Unearned income — such as other government benefits, investment earnings, interest, pension and retirement plan distributions, annuities, and capital gains — doesn't count.

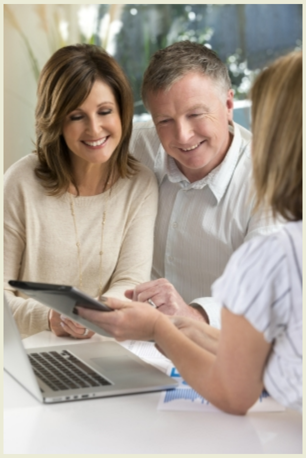
3. b. Benefits that are withheld are not really lost. Your benefit will be recalculated at full retirement age to account for the months benefits were withheld. You'll receive the higher benefit for the rest of your life, so assuming you live long enough, you'll eventually recoup the total amount you previously "lost."

4. d. Benefits paid to family members (such as your spouse or dependent children) based on your earnings record may also be reduced if you're subject to the earnings test. The earnings test does not apply to disability insurance benefits.

5. a. Many people retire mid-year and have already earned more than the earnings limit. So in the first year you claim retirement benefits, a monthly earnings test may apply, regardless of your annual earnings.

For example, let's say that you claim benefits at age 62 on September 30, 2020 and have already earned more than the 2020 earnings limit of $18,240. Then, you take a part-time job that pays you $1,000 per month for the rest of the year. You'll still receive a Social Security benefit for October, November, and December because your earnings are less than $1,520, the monthly limit that applies in 2020.

Estate Planning: Consider the Tax Basis of Gifted or Inherited Property



An asset's tax basis can be important when deciding whether to make gifts now or transfer property at your death. When you make a gift of property during your lifetime, the recipient generally receives your basis in the property. When you transfer property at your death, the recipient generally receives a basis equal to the fair market value of the property as of the date of your death. The difference can substantially affect the amount of taxable gain when the recipient sells the property.

Tax basis can be important when deciding whether to make gifts now or transfer property at your death. This is because the tax basis of the person receiving the property depends on whether the transfer is by gift or at death. This, in turn, affects the amount of taxable gain subject to income tax when the person sells the property.

What is tax basis?

The tax basis of an asset is used when determining whether you have recognized a capital gain or loss on the sale of property for income tax purposes. (Gain or loss on the sale of property equals the difference between your adjusted tax basis and the amount you realize upon the sale of the property.) When you purchase property, your basis is generally equal to the purchase price. However, there may be some adjustments made to basis.

What is the tax basis for property you receive as a gift?

When you receive a gift, you generally take the donor's basis in the property. (This is often referred to as a "carryover" or "transferred" basis.) The carryover basis is increased — but not above fair market value (FMV) — by any gift tax paid that is attributable to appreciation in value of the gift. (Appreciation is equal to the excess of FMV over the donor's basis in the gift immediately before the gift.) However, for the purpose of determining loss on a subsequent sale, the carryover basis cannot exceed the FMV of the property at the time of the gift.

Example: *Say your father gives you stock worth $1,000 and the gift incurs no gift tax. He purchased the stock for $500. Your basis in the stock, for the purpose of determining gain on the sale of the stock, is $500. If you sold the stock for $1,000, you would have gain of $500 ($1,000 received minus $500 basis).*

Now assume that the stock is only worth $200 at the time of the gift and you sell it for $200. Your basis in the stock, for the purpose of determining gain on the sale of the stock, is still $500, but your basis for determining loss is $200. You do not pay tax on the sale of the stock. You do not recognize a loss either. In this case, it would have been better if your father had sold the stock (and recognized the loss of $300 — his basis of $500 minus $200 received) and then transferred the sales proceeds to you as a gift.

What is the tax basis for property you inherit?

When you inherit property, you generally receive an initial basis in property equal to the property's FMV. The FMV is established on the date of death or on an alternate valuation date six months after death. This is often referred to as a "stepped-up" basis, since basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

Example: *Say your mother leaves you stock worth $1,000 at her death. She purchased the stock for $500. Your basis in the stock is a stepped-up basis of $1,000. If you sold the stock for $1,000, you would have no gain ($1,000 received minus $1,000 basis).*

Now assume that the stock is only worth $200 at the time of your mother's death. Your basis in the stock is a stepped-down basis of $200. If you sold the stock for more than $200, you would have gain.

Make gift now or transfer at death?

As the following example shows, tax basis can be important when deciding whether to make gifts now or transfer property at your death.

Example: *You purchased land for $25,000. It is now worth $250,000. You give the property to your child (assume the gift incurs no gift tax), who then has a tax basis of $25,000. If your child sells the land for $250,000, your child would have taxable gain of $225,000 ($250,000 sales proceeds minus $25,000 basis).*

If instead you kept the land and transferred it to your child at your death when the land is worth $250,000, your child would have a tax basis of $250,000. If your child sells the land for $250,000, your child would have no taxable gain ($250,000 sales proceeds minus $250,000 basis).

In addition to tax basis, you might consider the following questions:

- Will making gifts reduce your combined gift and estate taxes? For example, future appreciation on gifted property is removed from your gross estate for federal estate tax purposes.
- Does the recipient need a gift now or can it wait? How long would a recipient have to wait until your death?
- What are the marginal income tax rates of you and the recipient?
- Do you have other property or cash that you could give?
- Can you afford to make a gift now?

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Should I sign up for an identity theft protection service?

Unfortunately, data breaches are now normal, everyday occurrences in our society. As a result, many companies are offering services to help you protect your personal information. If you want an extra layer of protection, an identity theft protection service is a good option. However, the term "identity theft protection service" can be misleading. The reality is that no one service can safeguard all of your personal information from identity theft. What most of these companies actually provide are identity theft monitoring and recovery services.

A monitoring service will watch for signs that an identity thief may be using your personal information. This typically includes tracking your credit reports for suspicious activity and alerting you whenever your personal information (e.g., Social Security number) is being used. The recovery portion of the service usually helps you deal with the consequences of identity theft. This often involves working with a case manager to help resolve identity theft issues (e.g., dealing with creditors or placing a freeze on your credit report). And depending on the level of protection you choose, the service may also provide reimbursement for out-of-pocket expenses directly associated with identity theft (e.g., postage, notary fees) and any funds stolen as a result of the identity theft (up to plan limits). Identity theft protection services usually charge a monthly fee. Entry-level plans that provide basic protection (e.g., Social Security number and credit alerts) can cost as little as $10 a month, while plans that offer more advanced features (e.g., investment account monitoring) will cost more.

Keep in mind there are steps you can take on your own to help protect yourself against identity theft, such as:

- Check your credit report at least once a year for errors
- Periodically review your bank and debit/credit card accounts for suspicious charges/activity
- Obtain a fraud alert or credit freeze if necessary
- Have strong passwords, use two-step authentication, minimize information sharing, and be careful when shopping online

What are the new HRA options that will be available to employers in 2020?

Health reimbursement arrangements (HRAs) are employer-sponsored accounts that help employees pay for health-care expenses on a tax-advantaged basis. An employer establishes HRA accounts on behalf of employees and allocates a certain amount of money to them each year. Funds accumulate tax-free and are used to reimburse employees for qualified medical expenses such as health insurance premiums, routine medical bills, deductibles, and prescription drugs. Beginning in January 2020, employers can offer two new types of HRAs — an Individual Coverage HRA and an Excepted Benefit HRA.

Individual Coverage HRA (ICHRA). Employees can use funds allocated by their employer to buy their own health insurance on the individual market, subject to certain conditions. ICHRAs can also satisfy the Affordable Care Act (ACA) employer mandate as long as they provide sufficient funding to be considered "affordable." (Per the ACA, employers with 50 or more full-time employees are required to offer affordable health coverage that meets certain minimum standards.)

ICHRAs may be especially appealing to small employers that want to offer health coverage but have found traditional group plans to be cost-prohibitive. The U.S. Departments of Health and Human Services, Labor, and the Treasury, which issued the new rules in June 2019, estimate that approximately 800,000 small businesses will offer ICHRAs to their employees.

Excepted Benefit HRA (EBHRA). This type of HRA must be offered in conjunction with a traditional health plan. It allows employers to set aside a limited amount of funds ($1,800 per employee in 2020) to help pay for qualified medical expenses, including premiums for vision and dental insurance, COBRA coverage, and short-term, limited-duration insurance (not offered in all states). It is available even if the employee declines to participate in the primary plan.

Employees cannot be offered both an ICHRA and an EBHRA. Certain rules (including nondiscrimination rules), requirements, and conditions apply. For more information, review the new rules carefully and visit the FAQ page on the IRS website.

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