Charitable Rollover for IRAs: Reduce your taxes while maximizing deductions.

Congress has now made the popular “charitable rollover” a permanent part of the tax code. These Qualified Charitable Distributions (QCDs) allow **those aged 70½ and older** to instruct the administrator that his/her distribution from an IRA be paid directly to a charity. The tax advantage for some is that such a distribution is not taxable income.

Background

Generally, anyone who has reached age 72 (73 if you reach age 72 after Dec. 31, 2022) must begin taking distributions at least annually from IRAs and other retirement accounts, commonly known as Required Minimum Distributions (RMDs).

This distribution often results in greater income than is needed for living expenses and a higher income tax bracket which can result in capped deductions.

The mechanics

An eligible taxpayer (a person who has attained at least age 70½) directs the administrator of their IRA (Traditional or Roth IRA, or an inactive SEP or SIMPLE IRA) to send payment of up to $100,000 to a qualified charity.

The taxpayer does not include the distribution as part of taxable income and although the charity sends an acknowledgement, the contribution does not qualify for a charitable income tax deduction. Tax wise, it’s the equivalent – or better. For those who could fully deduct the charitable contribution, the tax effect is the same as the account owner took a distribution and then made an equal contribution; for those that would be unable to deduct the full donation, the direct way may reduce taxes by keeping the owner from having the increased income.

The benefit

If the gift doesn’t qualify for a charitable income tax deduction, is there still a tax benefit? Yes. The QCD counts toward the taxpayers’ required RMD. That RMD often causes a taxpayer to be pushed into a higher bracket. Those who don’t need the cash may want to avoid this result.

Additionally, those in a high-income tax bracket are sometimes unable to fully deduct charitable and/or other deductions which typically qualify. The direct payment may solve one or both issues.

Already taken RMD?

Those who have already taken their annual RMD may still want to take advantage of the QCD. The taxpayer won’t get a deduction, but she can still benefit her favorite charity and reduce RMDs in future years by reducing the account balance.

Don't have an eligible IRA?

QCDs can only be made from Traditional or Roth IRAs, including inherited IRAs, and inactive SEP and SIMPLE IRAs. The distribution cannot be made from a 401(k), 403(b), Keogh or other qualified plan. If an individual only has assets in a plan that isn't eligible, he may wish to prepare for next year by rolling assets from an ineligible plan to a Traditional IRA from which a QCD can be made the following year.

Which charities may qualify for distributions?

The charitable organization must be a public charity and cannot be a donor advised fund, supporting organization, trust or in most instances, a private foundation.

Do I need an acknowledgment from the charity?

If the charitable organization does not send you a written acknowledgment of the distribution, you may wish to inquire and inform the organization of your donation and request written acknowledgement of (1) the gift amount, (2) that the organization is a public charity qualified to receive donations from IRAs, and (3) that the gift will not be distributed to a donor advised fund or supporting organization, and that no goods or services were received by you in exchange for the contribution.

Top candidates for a Qualified Charitable Distribution

The qualified charitable distribution may be particularly appealing if:

- **Your RMD is excess income, and you want to make a charitable gift.** Making a QCD allows you to satisfy your charitable goals with dollars that would otherwise increase your taxable income.

- **You take the standard deduction and make charitable gifts.** Approximately two-thirds of taxpayers take the standard deduction and do not deduct the value of their charitable gifts. Making a QCD is essentially equivalent to itemizing a fully deductible charitable gift. If the charitable gift would otherwise be the only available itemized deduction, you may come out ahead tax-wise.

- **You itemize deductions and typically max-out your charitable deductions.** If you itemize deductions on your income tax return and typically meet or exceed the adjusted gross income ceiling for the deductibility of your charitable gifts (e.g., 50% of adjusted gross income for cash gifts), the qualified charitable rollover effectively constitutes an additional charitable deduction. The QCD is not counted toward the limit because you don't receive a deduction. If you want to give more than the limits, the QCD is an ideal way to accomplish that goal.

- **You itemize deductions and want to maximize other allowable deductions.** By avoiding the recognition of income and a charitable contribution deduction, you may be able to avoid or minimize the reduction of other allowable deductions that are tied to your adjusted gross income, such as the 10% adjusted gross income floor on medical expense deductions and the 2% adjusted gross income floor on miscellaneous itemized deductions.

- **Your state does not allow state income tax charitable deductions.** There are several states that either have no deduction for charitable gifts or have a limited deduction. The QCD allows you to make a charitable gift without increasing your gross income due to an RMD.

- **You have non-deductible contributions in your Traditional IRA and are considering a Roth Conversion.** QCDs are treated as coming first from any nondeductible contributions to a Traditional IRA. This means that you may be able to do a tax-free Roth conversion.

  How it Works: You have a Traditional IRA with a balance of $100,000, consisting of $20,000 of non-deductible contributions and $80,000 of deductible contributions and earnings. You have no other IRAs. A total of $80,000 is distributed to a qualifying charity from the IRA.

  Under present law, the distribution is treated as consisting of deductible (which are later taxable) contributions first. The total amount that would be includible in income but for the QCD if all amounts were distributed from the IRA is $80,000.

  Note that if your state does allow such deductions and doesn't tax IRA distributions, the effect may be the opposite – your state income tax could be higher than if you used other assets to make the deductible gift.

  Because it is a QCD, no part of the distribution is includible in your income for the year. For purposes of determining the tax treatment of other distributions from the IRA, $20,000 of the amount remaining in the IRA is treated as your non-deductible contributions (i.e., not subject to tax upon distribution).

  You now want to convert the remaining $20,000 of nondeductible contributions to a Roth IRA. If you have no other IRAs (other than the one which holds the $20,000 of now nondeductible contributions), you have essentially provided for a tax-free conversion to a Roth IRA by removing the deductible or taxable portion of your Traditional IRA through the qualified charitable rollover.

Conclusion

A QCD can be tax advantageous for any eligible taxpayer who wants to maximize charitable income tax contributions in a tax efficient manner. Contact your TIAA-CREF Advisor for assistance with your RMDs and other income strategies.

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