IRA Charitable Rollovers

Understanding IRA Charitable Rollovers (also known as Qualified Charitable Distributions)

For taxpayers who have investments in pretax retirement accounts (such as IRAs, 401(k)s, IRA annuities), the IRS requires that taxable distributions be taken from these accounts (with a few exceptions) on an annual basis once the owner reaches the age of 72 (increased from 70.5 in 2020 with the passing of the SECURE Act). These are called Required Minimum Distributions or "RMDs." They begin as a relatively small percentage of all pretax assets; however, the annual percentage is based on life expectancy, so the required distribution tends to increase gradually over time. Depending on the total amount of assets held in pretax retirement accounts, these RMDs can become very large over time and create a higher tax burden when combined with other retirement income streams, particularly because the distributions are taxable as ordinary income in the year received.

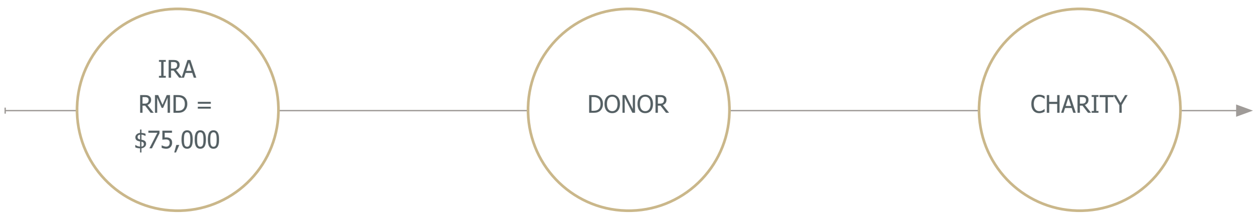
For IRA owners who are charitably-inclined and who don't require these distributions for cash flow, the IRA Charitable Rollover (also known as a Qualified Charitable Distribution or "QCD") can be a very effective strategy. IRA Charitable Rollovers are a special provision in the tax code that allows an IRA owner to make a tax-free gift of up to $100,000 directly from the taxpayer's IRA to an eligible charity (or charities) of their choosing. The maximum can be reduced, however, if the individual makes deductible IRA contributions beyond age 70.5.

Let's consider two scenarios below. In both cases, the IRA owner is required to take a Required Minimum Distribution of $75,000 from their IRA. They also want to give that entire amount to a qualified charity.

In Scenario 1, the RMD is distributed to the IRA owner, who then writes a check to the charity. The entire distribution is added to the IRA owner's gross income for that tax year. The charitable contribution of $75,000 can be added to schedule A as an itemized deduction subject to a limitation of 60% of their Adjusted Gross Income (increased to 100% of AGI with the passing of the CARES Act in March 2020) for the year. But in a case where the standard deduction ($24,800 plus $2,600 for senior married couples in 2020). is greater than the total of all itemized deductions, the IRA owner does not receive a tangible tax benefit for making the donation.

In Scenario 2, however, the RMD is distributed directly from the taxpayer's retirement account or IRA to the charitable organization. In this case the IRA owner's RMD is satisfied but the distribution is not included in taxable income. This particular donation is not itemized as a deduction on schedule A, because it has already been excluded from taxation. Other gifts to charity may still be itemized, however.

Scenario 1: Donor takes required minimum distribution from IRA, then donates it to charity



- Charity receives the full $75,000 donation
- IRA owner satisfies Required Minimum Distribution and must add RMD amount to gross income
- IRA owner then donates $75,000 to charity – ability to deduct this cash contribution subject to 60% of Adjusted Gross Income limitation (increased to 100% of AGI with the passing of the CARES Act in March 2020).
- (In the case of a smaller charitable contribution, if standard deduction is greater than itemized deductions, donor effectively receives no additional tax reduction benefit from having made this donation)
- IRA owner is still free to itemize other charitable donations on Schedule A if advantageous
- However, certain other deductions may be limited/reduced due to higher AGI

Scenario 2: Donor distributes required minimum distribution directly from IRA to charity

- Charity receives the full $75,000 donation
- IRA owner satisfies Required Minimum Distribution without adding RMD to Adjusted Gross Income. This can help reduce the taxability of Social Security income, and can help prevent the loss/ reduction of certain other deductions
- No Federal income tax owed on RMD regardless of whether IRA owner itemizes deductions or not
- IRA owner is still free to itemize other charitable donations on Schedule A if advantageous

Who might benefit from utilizing this strategy?

- Retirees who have pretax accounts and are charitably-inclined
- Retirees who potentially stand to lose certain deductions because their Adjusted Gross Income will be increased by the amount of their Required Minimum Distribution
- Retirees who don't itemize their deductions because their combined Itemized Deductions including charitable donations are less than the Standard Deduction

Please note that the above applies to Federal Income Tax only – retirees should discuss their state's rules with their tax advisor. Also, there are a few limitations and restrictions regarding the Qualified Charitable Rollover. For example, the distribution must be made directly from the IRA Trustee to a qualified charity. The distribution also cannot be transferred to donor-advised funds or private foundations. Furthermore, the gift cannot be made in exchange for a charitable gift annuity or into a charitable remainder trust. Also, beginning in 2020, the new SECURE Act permitted deductible IRA contributions for workers over 70.5, but any such contributions will reduce that person's eligible QCD amount. The above examples assume no deductible IRA contributions were made during the same tax year. Lastly, IRA Charitable Rollovers cannot also be deducted as charitable contributions on Schedule A. As with any such strategy, please consult with your tax advisor prior to implementation to confirm the impact and reporting requirements.

This article was originally published on May 15, 2019 and has been updated for accuracy as of May, 21 2020.

HIGHTOWER
EWING/CONA WEALTH MANAGEMENT

Five Greentree Centre | 525 Route 73 North
Suite 306 | Marlton , NJ 08053
(856) 291-9300
hightoweradvisors.com/ewingcona