Qualified Charitable Distributions

Use QCDs To Transfer IRA Funds To Charity

After your retirement, or if you're retiring soon, you may be more inclined to make donations to charity. However, you may receive little or no tax benefit from your contribution, depending on whether you itemize deductions. As a result, you might rely on a tax code provision to achieve your charitable intentions. With this technique, you arrange to transfer qualified charitable distributions (QCDs) directly from an IRA to a qualified charitable organization.

IRA Distributions

In the normal course of events, distributions from a traditional IRA are taxed at federal income tax rates topping out at 37%. The distributions can also cause net investment income tax (NIIT) complications. Therefore, retirees may decide to postpone IRA distributions as long as federal law allows.

Of course, if you take distributions from an IRA and contribute the money to a charity, you may claim a deduction for the monetary contribution if you itemize deductions. In effect, at best the contribution can offset the taxable income. But recent tax legislation has increased the standard deduction, potentially eliminating the tax benefit of charitable contributions for some taxpayers.

If you didn't itemize deductions in 2021, you were allowed a limited charitable deduction of up to $300 ($600 for joint filers). This tax break hasn't been extended for 2022. Current tax law creates an opportunity for certain older individuals to include QCDs in their estate plans.

QCDs In Action

By using QCDs, you avoid the "middleman" for a transfer of IRA funds to charity. In other words, the money goes directly from your IRA to the organization. It never touches your hands. You must make the necessary arrangements with your IRA custodian.

The payoff: If certain requirements are met, the transfer isn't treated as a taxable distribution subject to federal income tax. Conversely, you can't deduct the contribution either, even if you itemize. Essentially, it's a "wash" for federal income tax purposes.

To qualify for this tax treatment, you must be at least 70½ years old at the time of the transfer. In addition, the maximum annual QCD allowed under law is $100,000 per taxpayer. A married couple can double this amount to $200,000 if each spouse qualifies and contributes the full amount.

Be aware that certain charities — including donor-advised funds, private foundations and supporting organizations — aren't eligible to receive QCDs. While Roth IRAs may be used for QCDs, there's generally no tax advantage to doing so. In fact, if you want to use the assets in your Roth IRA to fund a charitable contribution, in most instances it would, from a tax perspective, be better to *not* to make a QCD from the Roth IRA. Rather, take the withdrawal and then make the contribution directly to the charity.

How QCDs Affect RMDs

Notably, a QCD satisfies the rules for required minimum distributions (RMDs) from traditional IRAs. This is often cited as a main reason for arranging QCDs — if not the sole reason.

With a traditional IRA, you must begin taking RMDs by April 1 of the year following the year in which you turn age 72. Then you must continue to take RMDs in each succeeding year. The RMDs are based on life expectancy tables from the IRS and the value of the account on December 31 of the prior year.

RMD rules also apply to beneficiaries who've inherited traditional IRAs. But mandatory lifetime distributions aren't required for participants in Roth IRAs. (Roth IRA beneficiaries must empty out their accounts under special rules.)

Other Tax-related Considerations

Be aware that a QCD reduces your adjusted gross income for various other tax purposes. This can have a domino effect on the rest of your tax return, including deductions and credits you may claim, alternative minimum tax liability and imposition of the NIIT.

Also, if you're receiving Social Security benefits, the benefits are subject to tax under a complex formula. A QCD enables you to effectively lower your income for this calculation, thereby potentially reducing your tax liability.

Is a QCD the right move for you? Turn to your estate planning advisor for the answers.

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