Key Private Bank

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A Review of Qualified Charitable Distributions and How You Can Supercharge Them

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The qualified charitable distribution provisions allow IRA funds to be withdrawn at a zero-percent rate and can offset the income from a required distribution.

In this article, we'll review how this works, its limitations, and how you can use this as a result of other provisions in recent tax law to expand charitable gifts for 2021.

Important terms defined:

Required Minimum Distributions: Required minimum distributions (RMDs) are amounts the federal government requires you to withdraw annually from certain retirement savings vehicles after reaching age 72, which increased from 70 ½ as part of the 2019 SECURE Act. This includes various account types like traditional IRAs, SEP-IRAs, and SIMPLE IRAs.

For 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) waived RMDs for the tax year. RMDs are required for 2021 and must be taken **before December 31, 2021.**

Qualified charitable distributions (QCDs) - These enable you to make tax-advantaged donations from your IRA during your lifetime. An individual who is 70 1/2 or older can take a non-taxable distribution of up to $100,000 from their IRA if that distribution is made directly to a charity.

How QCDs work

Since any potential income taxes owed on these distributions are eliminated as long as funds go directly to a charity, QCDs are not included in adjusted gross income (AGI). QCDs have been attractive for individuals who don't need or want the funds from their RMDs and would incur increased tax liabilities if distributions were taken as income.

While QCDs are available in 2021, you may find other preferred methods for donations based on your specific situation.

When gifting vehicles other than QCDs may be optimal:

Suppose you are an itemizing tax filer (total itemized deductions of greater than $12,550 for individuals and $25,100 for married filing jointly). In that case, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTRA), a part of the Consolidated Appropriations Act, 2021 (CCA, 2021), allows you to claim an itemized charitable deduction of up to 100% of AGI for cash contributions made to a 50% limitation charity in 2021. The most common 50% charities include churches, schools, hospitals, governmental entities, private operating foundations, and other nonprofit agencies organized for charitable, religious, educational, scientific, or literary purposes. Typically, individuals are capped at 60% of AGI for cash contributions. This is a one-time unlimited cap on cash donations to qualified 50% limitation charities for 2021.

A donation of appreciated stock may be advantageous for tax purposes in 2021 if you itemize. The charitable deduction can be captured while permanently eliminating unrealized capital gains and diversifying a portfolio that may be concentrated.

Using a method such as cash rather than a QCD for 2020 gifting allows your IRA assets to recover from a market decline.

When using QCDs may be optimal:

You may decide to use IRA assets for a QCD if other assets are limited. Making a QCD can lower future RMDs by reducing your IRA balances.

A QCD may provide multigenerational tax benefits if you are in a lower tax bracket than your IRA beneficiary. You may wish to reduce your taxable IRA balances for a non-spouse designated beneficiary in light of the SECURE Act, which mandates that funds be distributed over ten years following an IRA account owner's death.

How to Supercharge a QCD

A regular QCD has some limitations. First, distributions are limited to IRAs and do not include other workplace retirement accounts such as 401(k)s. There is proposed legislation that would extend the QCD provisions to other types of retirement accounts-- but, for now, limited to IRAs. Second, the QCD is limited to $100,000 per year, not inflation-adjusted.

Here is how you supercharge the QCD strategy. You take a distribution from any retirement account (not just an IRA) to be given to a charity for a 100% charitable deduction for those that itemize their deductions. This could potentially free up other itemized deductions like state and local taxes and mortgage interest to be claimed, increasing the overall tax benefit.

For example, an IRA owner with a large IRA who wishes to use those funds to make a sizeable charitable gift could take a withdrawal from his IRA and give the cash to a qualified charity and receive a 100% offsetting deduction.

There are a few downsides to consider. Federal and state income taxes may have to be withheld from the retirement account distribution, but a good portion of that could be refunded upon filing the 2021 tax return. Also, the increased income would naturally increase AGI, which could reduce or eliminate certain AGI-based tax deductions, credits, and other benefits. Medicare IRMAA surcharges could also be increased as well as the taxation of Social Security benefits.

Some states do not allow itemized deductions. You could increase state taxable income without an offsetting state income tax deduction.

The downside considerations for those individuals who wish to gain tax benefits from making a sizeable charitable gift may be insignificant in the overall tax planning picture. This could be good for those under age 70 1/2 and who don't qualify for a QCD. However, it is not advisable for those under age 59 1/2 as that would trigger a 10% early distribution penalty. It is also not advisable to use Roth IRA funds since there is no tax benefit gained.

And finally, remember that the 100%-of-AGI limit for deducting cash gifts to charity does not apply to door-advised funds or gifts to other supporting organizations.

Review your gifting alternatives

Recent legislation creates some unique considerations for people taking RMDs and making charitable contributions in 2021. In general, individuals who already planned to make charitable gifts and file their taxes using the standard deduction should think about gifting via QCDs.

Itemizing filers should weigh other options for their 2021 charitable gifts, such as cash or appreciated stock. Also, consider supercharging a QCD by taking a distribution from a retirement account, making a charitable cash contribution to a qualified charity, and receiving a 100% deduction.

As always, you should review any plans for charitable donations and withdrawals from your IRA or other retirement accounts with your tax advisor.

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