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QCDs: Use This Tax Strategy to Get More From 2018 RMDs

Under the new tax law, those taking RMDs can get a tax break even without itemizing by giving to charity. Here's how qualified charitable distributions can pay off beyond good deeds.

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This year marks the beginning of a new era in tax planning. The newly minted GOP tax law is now in effect, and it's likely that your annual tax calculations will need to change.

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While most taxpayers will benefit from reduced tax rates and expanded tax brackets, changes in the law also mean it's less likely that you will itemize your deductions, instead opting to claim the higher standard deduction. And while that's not necessarily a bad thing, it means rethinking your strategy as it relates to minimizing your tax bill.

That's where a qualified charitable distribution (QCD) can help. Here's why you might need one.

How will the new standard deduction impact my charitable giving?

To maximize your deductions, you claim the larger of the standard deduction or the total of your itemized deductions. For example, under pre-2018 laws, a 70-year-old retired couple who pay $10,000 in state income tax, $5,000 in property taxes and $10,000 in charitable gifts would typically itemize their deductions, because they total $25,000 vs. their $15,200 standard deduction ($12,700 plus $1,250 over age 65 per person additional deduction). In this case, the couple obtained a financial benefit for their charitable donations.

Under the new 2018 law, however, the deduction for state and local taxes (both on income and property combined) is capped at $10,000. As such, their itemized deductions would now only total $20,000. In this case, instead of itemizing, the couple would claim the $26,500 standard deduction for married couples ($24,000 plus $1,250 over age 65 per person additional deduction).

To be clear, when you claim the standard deduction, you get no financial benefit for any of your itemized deductions, including your charitable donations. However, if you're taking required minimum distributions (RMDs) from your traditional IRA, there's a smart strategy that will still allow you to obtain a financial benefit from your charitable donations, even if you're still claiming the standard deduction.

Reintroducing Qualified Charitable Distributions (QCDs)

Using a QCD is a tax-savvy strategy that allows you to transfer up to $100,000 per year from your IRA directly to a qualified charity. It is only available to IRAs and individuals who have reached RMD age (70.5). Any amount processed as a QCD counts toward your RMD requirement and reduces the taxable amount of your IRA distribution. This lowers both your adjusted gross income and taxable income, resulting in a lower overall tax liability.

So, if our 70-year-old couple, who have an annual RMD between the two of them of $24,000, can instead direct $10,000 of it to charity as a QCD, it will reduce their taxable income by $10,000 and they still get to claim the same $26,550 standard deduction. In this case, if the couple is in the new 24% tax bracket, by using this strategy, they would have saved $2,400 in federal taxes alone — and potentially more in state tax savings. As you can see, there is good reason to perform a QCD if you plan to take the standard deduction in 2018, which is why this strategy will likely become commonplace in 2018.

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Don't inadvertently miss out on a QCD

If you manually request your RMD each year, identify how you want to take advantage of the QCD before processing the RMD, because once you take out your distribution, you can't give it back.

If you are set up to automatically receive your RMD each year (especially early in the year), you may want to turn off the payment and instead request two distributions: the QCD and any remaining RMD amount. For example, if an individual is automatically set to receive a $24,000 RMD in January, they could stop the automatic distribution and subsequently request two distributions: a $10,000 distribution directly to a public charity of their choice, and a $14,000 regular distribution. Together, these will have satisfied the RMD requirement for the year.

If you automatically receive monthly distributions from your IRA, you will want to reduce this amount by what you intend to give to charity to preserve the QCD strategy. For example, if an individual is receiving $2,000 per month from their IRA ($24,000 over the course of the year), they will want to adjust the monthly payment down to $1,167 (so that they add up to $14,000 over the course of the year). That way $10,000 is preserved for the QCD strategy.

Tax Return Considerations for QCDs

Currently, your IRA custodian is not required to specially identify the QCD on your annual 1099-R form. Because of that, the responsibility is on you to inform your tax preparer that you performed a QCD. If you don't let your preparer know, they will likely report this transaction as fully taxable, which would negate the benefit of your smart planning.

Start planning for QCDs today

Even though the new law makes it more difficult to obtain a financial benefit for your charitable donations, all is not lost. If you are over age 70.5, consider taking advantage of the QCD. If you aren't at that age yet, consider how you can intentionally position yourself to take advantage of these rules once you do turn 70.5. Start by evaluating how much you save in tax-advantaged accounts and how you spend your savings to support your retirement lifestyle. By using, or preparing to use, a QCD, you can meet your RMD requirement, satisfy your charitable intents, all while saving money on taxes both today and into the future.

This information is not intended to be a substitute for specific individualized tax advice. I suggest that you discuss your specific tax issues with a qualified tax adviser to see if this strategy makes sense for your unique situation and consider the following questions:

- Are you likely to claim the standard deduction, and would you benefit from a QCD?
- If you are younger than age 70½, how should you adjust your retirement spending to take advantage of this provision once you do turn 70½?

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