Required Minimum Distributions, Qualified Charitable Distributions, and the Impact of 2018 Federal Income Tax Changes on Charitable Contributions

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Situation Analysis:
Many taxpayers contributed to **Individual Retirement Accounts (IRAs)** for years, are age 70-1/2 or older, and now face mandatory withdrawals that can substantially add to taxable income and their tax liability. This can present financial challenges.

Summary Objectives:

1. Define and explain **Required Minimum Distributions (RMDs).**
2. Define and explain **Qualified Charitable Distributions (QCDs).**
3. Provide information on a strategy and potential option available to many taxpayers with an IRA that are 70-1/2 and older, or are nearing that age. This strategy/option can offer a tax savings while giving to others through **QCDs.**
4. Relate the impact of the 2018 U.S. Federal income tax restructure designed to reduce taxes and simplify tax filing. Specifically, one of the significant changes involves standard deductions that were increased to accommodate a much larger population of taxpayers who previously itemized their deductions.
   - *The Bad News* … this will likely affect charitable contributions since these expenses will now be transparent within the standard deduction category.
   - *The Good News (at least for those 70-1/2 or older with IRAs and RMDs*) … transparency under the standard deduction category may work for you, as it could allow you to take advantage of a smart, tax-savings strategy through QCDs.
5. State arrangements necessary for QCDs to be IRS compliant, and required information for donations.

The sections below address each of the above objectives.

Situation Analysis: How did the IRA / RMD challenge occur and what can we do about it?
Those of us who have IRAs knew the time would come when taxes would need to be paid on our pre-tax savings. The premise was our income and tax rate would be lower when our RMDs commenced. What some of us may not have fully grasped nor accurately anticipated was our taxable income at retirement—the total of our pensions, annuities, Social Security benefits, interest, dividends, capital gains, etc. On the surface, more income sounds like a good problem to have. However, when you add substantial pre-tax RMDs which trigger increases and adjustments to other items, suddenly our new tax liability is staggering. While those withdrawing an RMD for the first time speak of their shock and angst, not taking the RMD was not an option due to the severe federal penalty taxes. So the question is, what can we do to mitigate the trauma of RMDs and/or identify a strategy that will work for us to achieve a tax advantage/savings benefit? Let's start with the basics, the strategy will follow!

1. **What are Required Minimum Distributions (RMD)?**
   - A RMD is the minimum amount you must withdraw each year from your traditional IRA account, almost always the year you reach age 70-1/2.
   - The **RMD** for each year is determined by dividing the IRA account balance as of December 31 of the prior year by the applicable life expectancy factor (available in the IRS Uniform Lifetime Table by locating your age, then life expectancy).
   - The RMD may be withdrawn throughout the year, in whole or part, as long as the total requirement of the RMD is withdrawn by December 31st.
   - RMD withdrawals count as "above the line" from a tax perspective, and are combined with other taxable income. As such, RMDs increase your Adjusted Gross Income (AGI) and tax liability.
     - In addition, RMDs can impact other items, increasing the taxable amount of Social Security benefits, driving income-related adjustments, and causing Medicare Part B and Part D premiums to go up.
     - RMDs can also affect your income tax bracket.

- Amounts can be withdrawn from your IRA greater than your annual RMD. However, the total amount withdrawn is treated as taxable income in that year, except for QCDs up to the amount allowable.
- If individuals don't take their RMD withdrawals, or take less than they should, they will owe a **50 percent federal penalty tax** on the difference between the amount withdrawn and the amount that should have been withdrawn. This penalty tax is added to the RMD requirement already owed.

2. **What are Qualified Charitable Distributions (QCDs)?**
   - A QCD is a <u>direct payment</u> of an RMD by an IRA Trustee/Custodian, to a <u>qualified charity</u>; i.e. a 501(c) (3) non-profit organization. It must be issued in the charity's name and sent directly to them or will be taxable.
     - You can also request your IRA Trustee/Custodian send QCDs to multiple qualified charities the same year.
     - Charities not qualifying for QCDs include private foundations and donor-advised funds.
   - QCDs apply toward your annual RMD requirement, in whole or in part, up to the maximum annual exclusion from taxable income of $100,000.
     - QCDs can exceed your annual RMD, if you wish to make one or more substantial charitable contributions while living.
     - If any QCD is in excess of the $100,000 limit, it will be included in taxable income along with other distributions.
     - For joint returns, a spouse can also have a QCD up to maximum annual exclusion of $100,000.

<u>QCD Scenarios/Examples</u>

- If 70-1/2 or older with an IRA and currently have an RMD set up for automatic payments annually (especially early in the year), you may want to turn off the payment and instead request two distributions (1) a QCD for the charitable contribution, and (2) the remaining RMD amount for personal use or reinvestment.
  - *<u>Example</u>: You had set to automatically receive a $24,000 distribution in January, the amount that satisfied your RMD requirement for the year. You could stop the automatic distribution and subsequently request two distributions, a $10,000 distribution sent directly to a qualifying charity of your choice (a QCD), and a $14,000 RMD.*

- If 70-1/2 or older and automatically receive monthly distributions from your IRA, you may want to reduce the amount by what you intend to give to charity to preserve the QCD strategy.
  - *<u>Example</u>: If an individual receives $2,000/monthly ($24,000/annually) from their IRA and wishes to give $10,000 to charity through a QCD, they will need to reduce the monthly amount of their IRA distribution to $1,167 ($14,000/annually) to preserve their strategy of a $10,000 QCD.*

3. **Are you aware of the tax-savings strategy that may be an option for you?**
   If you are 70-1/2 or older and have a traditional IRA there is a smart strategy involving your annual RMD that permits you to receive a tax benefit from QCDs. The extent of the tax savings, will, of course, depend on the size of your IRA account, and the amount of your annual RMD and QCD. *(Note: For you to use this strategy, it will be necessary to claim the new <u>standard deduction</u> explained in Section 5 below.)*
   - QCDs are not reflected as taxable income, trigger no adders, adjustments, or additional premiums, and are not included in Adjusted Gross Income. As such, QCDs do not contribute to your tax liability and do not potentially raise your tax bracket.
   - QCDs permit you to leverage pre-tax dollars for your charitable contributions versus using after-tax dollars.
   - QCDs can be used to fulfill your stewardship commitment, address a capital campaign pledge, or provide a gift in honor or memory of a loved one.

4. **Did you know 2018 tax changes will affect charitable contributions but may work for you?**
The 2018 Federal income tax increase in standard deductions assumes the amount is sufficient to include qualified expenses previously itemized by a much larger population. Consequently, many will no longer itemize expenses for charitable contributions, medical expenses, state and local taxes, mortgage interest, and real estate taxes, unless their expenses are above the new standard deduction amount and they can be substantiate the expenses with documentation in the event of a later audit.

- Treatment of QCDs under the 2018 Federal tax plan is as follows:
  - If taxpayers are using the new standard deduction when filing their taxes, they will automatically receive the benefit of the standard deduction amount according to their filing status, AND they will also receive the amount of the **QCD**, as a tax-free transfer up to the $100,000 annual maximum allowable exclusion from taxable income.
  - However, if taxpayers itemize deductions, they **cannot double-up on tax breaks** by taking the charitable contribution deduction on Schedule A and receive the benefit from the QCD as a tax-free transfer up to the $100,000 annual maximum allowable exclusion from taxable income.
- New standard deductions for 2018 are shown below:

Filing Status	Standard Deduction
Single	$12,000
Head of Household *(See the official IRS guidelines on their website)*	$18,000
Married Filing Separately	$12,000
Married Filing Jointly	$24,000
Qualifying Widow(er) *(See the official IRS guidelines on their website)*	$24,000
See additional Standard Deduction amounts below that will apply, as applicable	

  - **Additional Standard Deduction amounts**:
    - **Age:** If you are age 65 or older, you may increase your standard deduction by $1,600 if you file Single or Head of Household. If you are Married Filing Jointly and you OR your spouse is 65 or older, you may increase your standard deduction by $1,300. If BOTH you and your spouse are 65 or older, you may increase your standard deduction by $2,600.
    - **Blindness:** If you are legally blind, you may increase your standard deduction by $1,600 if filing Single or Head-of-Household. If you are Married Filing Jointly and you OR your spouse is blind, you may increase your standard deduction by $1,300. You may increase your standard deduction by $2,600 if BOTH you and your spouse are blind.
      - ✓ To qualify as blind by the IRS you must keep in your tax records that includes a certified letter from an eye doctor (or optometrist) stating that you have non correctable 20/200 vision in your best eye or that your field of vision is restricted to 20 degrees or less.

5. **How do you arrange a QCD?**
If you'd like to see your years of work make a real difference helping others, and at the same time receive a tax benefit, this is a wonderful opportunity to do so. We hope you'll consider a qualified charitable distribution (QCD) to St. Mark's United Methodist Church, and join us in the commitment to our mission:

"Changing the world through Christ, by caring for all people."

These instructions that follow are important for compliance with IRS requirements in order to receive tax benefits for QCDs:

A. Contact your IRA Trustee/Custodian, tell them you want a **qualified charitable distribution,** specify the amount, and identify the qualified charity. If you wish to name St. Mark's as the qualified charity and recipient of the QCD, your IRA Trustee/Custodian may request the following information:

St. Mark's United Methodist Church
1431 W. Magee Road, Tucson (Pima County), Arizona 85704
Telephone: 520/297-2062, email: info@umcstmarks.org

St. Mark's United Methodist Church was granted not-for-profit/charitable organization status under Section 501(c) (3) of the Internal Revenue Code. As a qualified tax-exempt organization under IRS rules, it meets criteria to receive a qualified charitable distribution (QCD). FEI Number: 86-0264983

B. Request the IRA Trustee/Custodian **issue a check payable to the qualified charity, and send the check directly to the charity.** *(Note: If the check is made payable to you and sent to you by mistake, it cannot be considered a QCD nor receive tax benefits. Further, if a RMD is payable and accepted by you, there is no way to roll it back into an IRA for use as a QCD. It will be counted as taxable income.)*

C. Retain the QCD documentation provided by the charity detailing the gift and amount donated as part of your RMD obligation.
   i. Provide this documentation to your tax preparer to ensure the amount is excluded from taxable income, and
   ii. Retain documentation on the QCD to substantiate the transaction as part of RMD fulfillment for the specific year, and in the event of a future IRS audit.

D. If there continues to be no special coding on the 1099-R form nor current requirement for the IRA Trustee/Custodian to report QCDs, **it is crucial that you inform your tax preparer that the RMD included qualified charitable distribution(s), AND provide the tax preparer with the supporting documentation.**
   i. QCDs not reported to the tax preparers as part of your annual RMDs will likely be shown as fully taxable, reflected in adjusted gross income, and increase your tax liability.

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- **If tax advisors or IRA Trustees/Custodians require assistance with Qualified Charitable Donations to St. Mark's United Methodist Church, please contact Ruth Kester, Bookkeeper at 520/297-2062.**