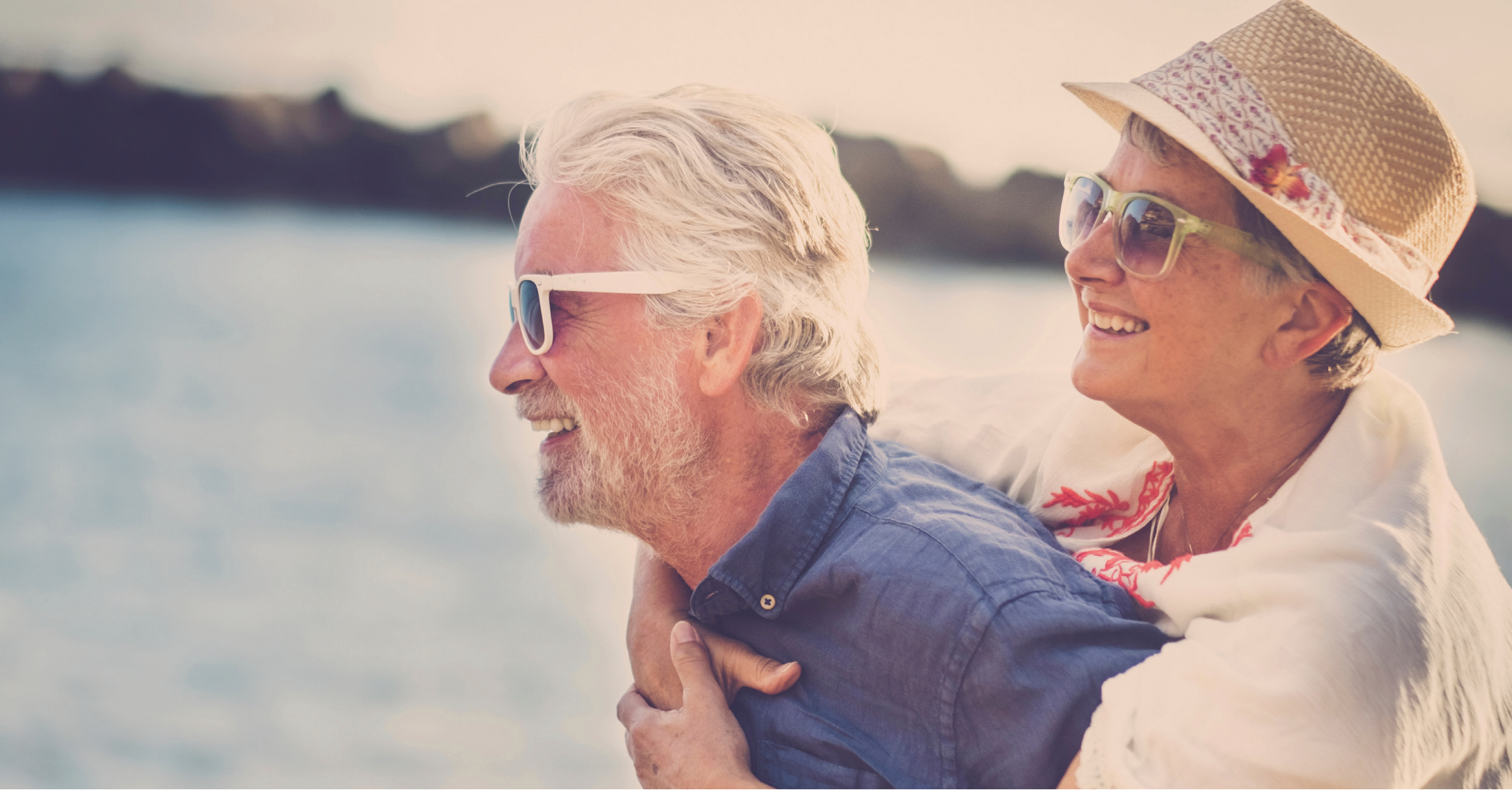
UNDERSTANDING DONATIONS

- A GUIDE -

QUALIFIED CHARITABLE DONATIONS: GIVING, WITH TAX BENEFITS

WH Cornerstone Investments



Building your retirement nest egg took years of dedication and effort. You focused on saving as much as you could – and on employing strategies that protected those savings from unnecessary taxes.

Once retired, you can make the most of all that effort by aligning your spending with your resources – and by always withdrawing funds from your nest egg in a tax-smart way.

This guide can help you do that.

Certain obligations come with withdrawing what you've accumulated in Individual Retirement Arrangement (IRA) accounts – the accounts that gave you tax advantages for setting money aside for retirement.

One such strategy uses Qualified Charitable Distributions (QCDs). It helps you withdraw from IRAs what you need to meet your Required Minimum Distribution (RMD) obligations in a way that benefits several aspects of your finances.

Let's look at those obligations.

What are my Required Minimum Distributions?

If you have traditional (non-Roth) IRAs, once you reach your RMD starting age, you must begin taking yearly money disbursements called RMDs. The RMD starting age has been increased recently from 70½ to 72, and now to 73, depending on your birth date:

- ☐ At 70½ if you reached 70½ before December 31, 2019.
- ☐ At 72 if you reach 72 between January 1, 2020, and December 31, 2022.
- ☐ At 73 if you reach 72 on or after January 1, 2023.

Withdrawals must be made by April 1 of the year following the year you reached your RMD starting age, whether you need the money or not. In future years, the withdrawal must be made by December 31 of that later year.

Because you never paid income taxes on the earnings you contributed to the traditional IRA, the IRS is eager to get its cut. (RMDs are not required of Roth IRAs since you paid taxes on those earnings before they were contributed to the retirement account.)

The amount of an RMD withdrawal is based on the account balance in that IRA on December 31 of the year preceding the year for which the RMD is being figured. For example, if you are calculating the RMD for 2023, you will consider the account balance on December 31, 2022. That balance is then multiplied by a percentage factor provided in an IRS table which reflects how many more years the IRS estimates as a typical life expectancy.

The amount you withdraw from a traditional IRA will be added to other income you've received during the year and taxed at your current ordinary income tax rate. You will also pay the penalty on whatever withdrawal was required that you didn't make. (Although the SECURE Act 2.0 lowered the 50% penalty to 25% and 10%, there's still no reason to incur a penalty.)

If you need the money from the withdrawal, the ordinary income tax you pay is the cost of having delayed paying taxes on the money – and its growth – since you first placed it in the IRA. But if you don't need or want it, is there a way to make the most of the withdrawal and have a tax benefit as well?

Yes, and it's called a **Qualified Charitable Distribution (QCD)**.

While QCDs have been available since 2006, they finally became permanent in 2015 through the Protecting Americans from Tax Hikes (PATH) Act. Since then, QCD rules have been updated through the SECURE Act of 2019 and SECURE 2.0 in 2022.

This guide will provide the latest rules around QCDs at the time of writing.

What is a Qualified Charitable Distribution?

A QCD offers the best of all worlds: you meet the annual requirement to withdraw funds from your IRA while making a difference during your lifetime – and you avoid paying income tax on the distribution.

While giving away money as a tax-smart strategy may seem counterintuitive, that's not necessarily the case. Let's look at how this works.

A QCD is a distribution you take from your tax-advantaged retirement account that goes directly to a charity instead of to you: a direct-from-IRA-to-charity transfer. Typically, you ask your IRA's custodian to send the money to an approved charity known as a "qualified charitable organization": a nonprofit that qualifies for tax-exempt status by the IRS.

The IRS defines a QCD as " … generally a nontaxable distribution made directly by the trustee of your IRA (other than a SEP or SIMPLE IRA) to an organization eligible to receive tax-deductible contributions."

The main benefit of a QCD is that the distribution can be counted toward your yearly RMD without being added as income to your Adjusted Gross Income (AGI). By excluding the RMD income, besides lowering your tax bill, you might avoid the following:

- Being pushed into a higher tax bracket.
- Being pushed into a higher percentage of your Social Security earnings that are taxable.
- Triggering the Alternative Minimum Tax (AMT).
- Being exposed to the 3.8% net investment income surtax.
- Having to pay Income Related Monthly Adjustment Amount (IRMAA) surcharges on your Medicare Part B and Part D premiums.

How IRMAA might affect your Part B and Part D premiums

Each year, Social Security looks back at your income tax returns two years earlier to decide if you need to pay IRMAA surcharges on your Medicare Part B and Part D premiums.

Say, for example, that your 2021 Modified Gross Income as a single individual was $155,000 instead of $95,000 because you didn't use a $60,000 QCD to meet your RMD requirements. Your monthly 2023 Part B premium would be $428.60 instead of the standard amount of $164.90. That's an annual difference of $3,164.40. For Part D, there would be no add-on to your plan premium at $95,000 but a $50.70 monthly add-on at $155,000.

A married couple filing jointly would face similar surcharges.

Why make a QCD instead of a traditional charitable gift?

By withdrawing funds from a retirement account, then giving the funds to a charity, the withdrawal would qualify as a taxable event. It would be added to your Adjusted Gross Income (AGI) and increase what you owe in taxes. You could claim a charitable tax deduction for your gift, but that may not be the best strategy for your tax situation.

With a QCD, even if you have hit your AGI limits for deductions for the year, disbursing funds from your IRA directly to a charity can unlock additional giving without increasing your tax burden. Your tax planner can tell you if a QCD is right for you.

Because the QCD does not trigger a taxable event, the charity can receive your total withdrawal instead of what's left after subtracting taxes.

Lastly, maybe you typically take the standard deduction on your taxes, and the amount you want to contribute is not high enough to be a net benefit to merit giving up the standard deduction. You can still claim the standard deduction and get a tangible tax benefit by doing your charitable giving out of an IRA as a QCD.

Summary of the rules guiding QCDs

For a distribution to qualify as a QCD, here is a summary of the basic rules that must be followed: pp. 14-16

- You have to be at least 70½ when you make the QCD.
- You can make a QCD starting at 70½ even if you haven't reached your RMD starting age of 72 or 73, although there won't be the tax benefit of applying it to RMDs.
- Your maximum annual exclusion is $100,000, or $200,000 if you file a joint return with your spouse. Anything beyond that will be considered taxable income.
- Your QCD must be made by your IRA custodian directly payable to an eligible charity without the funds going through your hands.
- Your QCD recipient must be a qualified 501(c)(3) organization eligible for tax-deductible contributions.
- You must obtain the same written acknowledgment from the charity as you'd need to claim a charitable contribution deduction on your taxes.
- You can't receive any benefit in return for your charitable donation made with a QCD.
- Your withdrawal must be made by the deadline for that year's RMD, typically December 31.

Am I eligible to make a QCD?

To be eligible to make a QCD:

- You must be 70½ or older when you request the QCD, or it will be treated as taxable income.
- You must have an IRA account, and all the accumulated contributions and earnings are eligible for QCDs.
- Funds can come from traditional, rollover, and inherited IRAs, but SEP and SIMPLE plans must be inactive, not ongoing. Funds cannot come from employer-based plans such as 401(k)s or 403(b)s. You may be able to make QCDs from Roth IRAs, but there is no tax benefit since they require no RMDs.

How much can I give as a QCD?

QCDs for a calendar year, whether as several QCDs or to multiple charities, cannot exceed $100,000 in total. Any amount beyond that does not qualify for offsetting your RMD. Excess amounts do not roll over to the following year, instead they would have to be taken as an itemized charitable deduction to have any taxable benefit.

If you file jointly with a spouse, you can make QCDs up to $200,000 in total as long as both spouses are age 70½ or over, both have IRAs, and each takes their QCD funds from their own IRA account. However, each is subject to the $100,000 limit; you can't share the limit and have one spouse give $150,000 while the other gives $50,000.

Thanks to the SECURE 2.0 Act, starting in 2023, you can make a one-time QCD of up to $50,000 to any of these popular planning arrangements: a charitable remainder unitrust, a charitable gift annuity or a charity remainder annuity trust.

One limitation: If you are still actively earning income and making contributions to a traditional IRA, that will affect how much of what you withdraw as QCDs is protected as nontaxable income. When the SECURE Act removed the age limit for IRA owners contributing to their accounts, people became simultaneously eligible for QCDs and IRA contributions. That could allow an in-and-out transaction: you could be taking a tax break for contributing funds to your IRA that you'd also be taking out as a QCD. You can still do both, but check with your tax advisor about the exact implications.

You can make part or all of your annual RMD distribution as QCDs. However, if the QCD total is smaller than your RMD, you must withdraw the RMD difference from your IRA and pay the related taxes. If your QCD equals your RMD, you will have satisfied your RMD without adding anything to your taxable income. Yet, if your QCD is larger than your RMD, you will have satisfied your RMD without adding anything to your taxable income, but the excess QCD will not roll over to future RMDs.

Scenario 1 | You take part of your RMD as a QCD:

Your annual RMD is $25,000	You make a $15,000 QCD	RESULT The remaining RMD of $10,000 will count as taxable income.

Scenario 2 | You take your entire RMD as a QCD:

Your annual RMD is $25,000	You make a $25,000 QCD	RESULT You satisfied your RMD and added nothing to your taxable income.

Scenario 3 | You take your entire RMD as a QCD and donate even more:

Your annual RMD is $25,000	You make a $25,000 QCD, plus an additional $10,000 QCD	RESULT You satisfied your RMD and added nothing to your taxable income. You reduced your IRA balance which could lower future RMD amounts. None of the additional $10,000 RMD will count towards fulfilling your future RMDs.

What organizations can receive my QCDs?

The organization you contribute to must be a 501(c)(3) eligible for tax-deductible contributions. Check the IRS's searchable database to be sure it qualifies under the IRS rules. Some other organizations may be eligible donees – such as some churches – and will not appear on the IRS search tool. The IRS also provides a list of Other Eligible Donees.

Helpful tool: *The IRS provides a search tool on its website to check if a charity is approved: Tax Exempt Organization Search*

You can't make QCDs to certain entities, such as Donor Advised Funds (DAFs). However, since the organization that sponsors your DAF is exempt as a 501(c)(3), you may still be able to make the QCD to that charity if it doesn't go into a DAF. QCDs also can't be made to private foundations or split-interest charitable trusts.

How do I set up a QCD?

Once you decide to make a QCD and choose your charity, advise your IRA custodian of the charity's details and the amount so a check or electronic transfer can be prepared. A check will be cut in the name of the charity and either sent directly to the charity or to you for forwarding – or it may be sent electronically. Remember that your withdrawal will become taxable if you first deposit the funds in your account, then write a new check to the charity.

Be sure to leave your IRA custodian enough time before the end of the year to complete a transaction, as it has to clear before December 31 to count for the current year.

The donation amount you designate as a QCD must be substantiated by a written acknowledgment from the receiving charity, stating the date and amount of the contribution and whether you – as the donor – received anything of value in return. It becomes ineligible if any part covers participation in an activity such as a gala or a golf tournament.

You can make QCDs even if you choose to itemize deductions on Schedule A of your Form 1040. However, the amount you transfer as a QCD – which will not be considered taxable income – cannot also be applied as an itemized deduction.

How do I report a QCD?

A QCD must be reported on your federal income tax return during that year's filing season. You will receive a form 1099-R from your IRA custodian showing any IRA distributions made during the prior calendar year, whether a regular distribution or a QCD. Your tax professional can help you correctly report each type of IRA distribution on your tax forms.

When the Tax Cuts and Jobs Act nearly doubled the standard deduction in 2018, countless charities lost contributions because so many opted to itemize their deductions no longer. Recent legislation has made some accommodations to help those charities access the remarkable generosity of Americans, and the evolving QCD is one of them.

In summary, if used correctly – and as part of an integrated retirement strategy – QCDs can offer you handy tax protection while you support the causes that matter to you. However, you want to be sure this form of tax-advantaged charitable giving works for your specific situation and that you have access to professional support to implement it seamlessly.

We are here to help.

Do you want to understand more about donor-advised funds? In the end, the goal is to maximize the ultimate value to those you aim to help and bring you the greatest joy.

For more specific advice on meeting your personal charitable giving goals, talk to us.

Learn more at www.whcornerstone.com.

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