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RETIREMENT PERSPECTIVES

Tax Reform Favors Charitable Giving from IRAs

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Qualified charitable distributions (QCD) are poised to become even more popular under the new tax law.

While the Tax Cuts and Jobs Act (TCJA) generally doubled the standard deduction, while eliminating many itemized deductions, financial advisors will want to update their clients on the potential tax-saving benefits of *qualified* charitable deductions (QCDs) now that they have been made permanent.

Remember that a charitable contribution is itself an itemized deduction, so most taxpayers will no longer receive the full deduction value—unless all other itemized deductions exceed the standard deduction amount. In other words, far fewer taxpayers will itemize, thus fewer taxpayers will be able to take advantage of the deduction for charitable giving.

Change Strategies

If due to the TCJA, the tax-saving value of a charitable contribution is not what you realized in prior years (i.e., results in a lower deduction), consider other options, such as qualified charitable distributions (QCD)

Why Qualified Charitable Distributions Are More Valuable Than Ever

QCDs can be a much more beneficial means of making charitable gifts for those taxpayers who are at least age 70½ and own an IRA. Why? A QCD allows a taxpayer to use a standard deduction and receive a tax break for donating IRA funds to a public charity. Donating a large IRA, for example, would save you from making required minimum distributions (RMDs), and reducing those RMDs via QCDs can have a significant impact on reducing your tax liability.

QCD Offers Big Benefits for Those 70½ or Older

QCDs allow an IRA owner or beneficiary age 70½ or older to donate up to $100,000 annually to a charity tax-free. If you are married, each spouse can transfer up to $100,000, for a total of $200,000 annually, assuming each IRA owning spouse is 70½. Not all charities, however, are eligible; for example, private foundations and donor-advised funds are ineligible.

Tip: The account owner or beneficiary must be 70½ at the time of distribution to qualify for a QCD.

How Do QCDs Affect Required Minimum Distributions (RMDs)?

The QCD can satisfy an RMD for the year; but, again, the QCD is capped at $100,000.

What Are the Advantages of QCDs?

One significant advantage for many IRA owners is that utilizing a QCD can satisfy your annual RMD, which means those funds are not included in your taxable income for the year. For IRA owners who do not need their RMDs for living expenses and want to avoid additional taxable income, a QCD is a valuable option. After all, reducing RMDs will lower reported gross income.

How Does One Donate QCD Assets?

Distributions must *go directly* to a public charity via trustee transfer. It's all right for proceeds to be mailed to an IRA owner–as long as the check is made payable to the charity. If the check is made out to the IRA owner, donating it would not qualify as a QCD.

Other QCD Rules to Keep in Mind

- IRA owner *must be* 70½.
- IRA owners may send up to $100,000 annually from an IRA directly to a public charity.
- QCDs are not available from employer-sponsored plans (e.g., 401(k), 403(b), 457, or active SEP and SIMPLE IRAs).
- Roth IRAs, although QCD-eligible, generally aren't appropriate. Roth IRAs have no lifetime RMDs; in addition, only taxable funds can be used for QCDs. A majority of Roth distributions will be tax free—there's no (tax) benefit to donating previously taxed funds. There is a special rule for those IRA owners who have accumulated nondeductible (aftertax) contributions. Distributions that QCD-qualify are taken from pretax funds first, instead of from pretax and aftertax funds proportionately. In other words, eligible QCDs are not subject to pro-rata distributions.
- QCDs are not included in taxable income (i.e., they do not increase adjusted gross income or AGI, which can have substantial tax benefits for high-bracket clients).
- A QCD does not qualify for a charitable deduction. But it does satisfy the annual RMD without increasing AGI, thus lowering or eliminating Social Security benefit taxation, Medicare premiums, alternative minimum tax, 3.8% investment surtax and medical expenses deductions, or being bumped to higher marginal tax bracket.
- Donor-advised funds and private foundations *do not* qualify.
- Be sure to discuss QCD processing and required paperwork with your IRA custodian.
- Tax reporting: Presently, there is no special coding on the 1099-R form reporting QCD. It's crucial that taxpayers make their tax professional aware that they took a QCD.

If you have any questions about this or another retirement topic, please e-mail me at **roadtoretirement@lordabbett.com**.

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GLOSSARY OF TERMS

Traditional IRA contributions plus earnings, interest, dividends, and capital gains may compound tax-deferred until you withdraw them as retirement income. Amounts withdrawn from traditional IRA plans are generally included as taxable income in the year received and may be subject to 10% federal tax penalties if withdrawn prior to age 59½, unless an exception applies.

A **Roth IRA** is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax deductible, but withdrawals during retirement are generally tax-free.

A **SIMPLE IRA** plan is an IRA-based plan that gives small-business employers a simplified method to make contributions toward their employees' retirement and their own retirement. Under a SIMPLE IRA plan, employees may choose to make salary reduction contributions and the employer makes matching or nonelective contributions. All contributions are made directly to an individual retirement account (IRA) set up for each employee (a SIMPLE IRA). SIMPLE IRA plans are maintained on a calendar-year basis.

A **simplified employee pension plan (SEP IRA)** is a retirement plan specifically designed for self-employed people and small-business owners. When establishing a SEP-IRA plan for your business, you and any eligible employees establish your own separate SEP-IRA; employer contributions are then made into each eligible employee's SEP IRA.

A **401(k)** is a qualified plan established by employers to which eligible employees may make salary deferral (salary reduction) contributions on an after-tax and/or pretax basis. Employers offering a 401(k) plan may make matching or nonelective contributions to the plan on behalf of eligible employees and may also add a profit-sharing feature to the plan. Earnings accrue on a tax-deferred basis.

A **403(b) plan** is a retirement savings plan that allows employees of public schools, nonprofit, and 501(c)(3) tax-exempt organizations to invest on a pretax and or Roth aftertax basis. Contributions to a 403(b) plan are conveniently deducted directly from your paycheck. In addition, your employer may elect to make a contribution on your behalf.

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