Using Qualified Charitable Distributions to Donate to First Parish

If you are age 70½ or older, the IRS has provided a tax-efficient way to deduct your charitable contributions to First Parish in Concord or any 501(c)(3) charitable organizations. If you are age 72 or older and taking your Required Minimum Distributions from your tax-deferred retirement accounts, you can also get a 2023 tax break. There are some rules and restrictions associated with using what are called Qualified Charitable Distributions (QCDs), but if you follow them, both you and First Parish can benefit.

Why it is now more difficult to deduct charitable contributions

The Tax Cuts and Jobs Act of 2017 (TCJA) includes provisions that constrain the ability to claim itemized tax deductions on Schedule A of the Federal tax return. First, it nearly doubled the standard deduction, which in 2023 for seniors (age 66 and older) is $30,700 for couples and $15,700 for singles. That increases the threshold for itemizing, as you deduct the higher of either the Standard or Itemized Deductions. Second, it eliminated Miscellaneous Deductions and put a cap of $10,000 on the State and Local Taxes (SALT) deduction. It left intact charitable donations, mortgage interest, and medical expenses above 7.5 percent of adjusted gross income (AGI). For those who have already paid off their home mortgages and do not have high out-of-pocket medical expenses, deducting charitable donations can be a challenge.

For example, let's say a retired couple age 73 has no mortgage, low out-of-pocket medical expenses, and take the maximum $10,000 in property tax (SALT) deduction. The only remaining itemized deduction they can take is Gifts to Charity. In this situation, their first $20,700 of charitable donations are not deductible, as the total is below their Standard Deduction. If they are in the 22 percent Federal marginal tax bracket, they are losing a $4,554 reduction of their taxes for 2023.

QCDs to the rescue

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 provided a method for many to get around the charitable donation restrictions of the TCJA. It created Qualified Charitable Distributions (QCDs), where those 70½ and older can gift to charities directly from their IRAs. Although there is no direct tax deduction for a QCD, it uses financial assets that will eventually be taxed at the Ordinary Income rate when withdrawn. Effectively, it avoids a future tax bill by gifting tax-deferred assets instead of after-tax ones that may not be deductible.

There is an added bonus of QCDs for those age 72 and older who must take required minimum distributions (RMDs) from their retirement accounts each year. Each dollar gifted with a QCD is one less RMD taxable dollar that must eventually come out of IRAs. Provided you do not need RMD withdrawals for living expenses, you can gift up to the amount of your annual RMD and eliminate that much taxable income. But you must adhere to the guidelines for QCDs to use them to your advantage.

The rules for using QCDs

If you qualify for using QCDs in 2023 and also want to reduce your RMD and the tax that comes with it for the year, you need to be aware of the RMD "First dollars out" rule. It states that the first withdrawals from IRAs each year count towards satisfying the annual RMD requirement. If those dollars are used for a QCD, they reduce the remaining RMD for the year. If you first take out the entire RMD in cash, then subsequent QCDs will not reduce your RMD, and thus not reduce your tax bill. Therefore, you should make all your QCDs before taking the rest of your RMD for the year.

A few other important QCD rules to follow:

- Payments must be made directly from the IRA to First Parish or the designated charitable organization. If it comes out first in cash, it is taxable income. Brokerages have withdrawal forms for doing this, most of which include a check box indicating a QCD.
- You cannot use QCDs for Donor Advised Funds (DAFs) such as Fidelity Charitable or Vanguard Charitable. The funds must go directly to charitable organizations.
- There is a maximum of $100,000 per person per year.
- QCDs can only be made from IRAs. They cannot come from employer plans such as 401(k)s or 403(b)s.
- QCDs above the RMD do not carry over to subsequent years to reduce future RMDs.

Also, do not use Roth IRAs for QCDs. This might seem obvious, but it is “tax-inefficient” to use tax-free assets when tax-deferred ones are available.

One last caution. Although IRA contributions can now be made at any age if you have qualified income, any tax-deferred IRA contributions after age 70½ will reduce the amount of QCDs excludable from taxation, effectively making part of the QCD taxable. This applies both forward and backward in time. Thus, do not make any IRA contributions after age 70½ if you intend to eventually make QCDs. Instead, contribute to Roth IRAs.

Q&A

Q: Is a QCD better than donating appreciated securities, another tax-efficient approach to charitable giving?

Donated securities avoid long-term capital gain taxes, though you still need to exceed the standard deduction threshold to deduct them, which is not an issue for QCDs. Also, appreciated securities are best bequeathed to heirs because of the inheritance step-up in basis, thus going to your heirs free of capital gains tax. As inherited IRAs now must be emptied within 10 years of the donor’s death, it is better to have your heirs receive appreciated securities rather than tax-deferred IRAs.

Q: How else can using QCDs benefit me tax-wise?

QCDs can reduce taxable RMD income, and thus lower your adjusted gross income (AGI) and modified adjusted gross income (MAGI), two figures that affect various tax deductions, credits, and surcharges. Potential benefits of reducing your MAGI/AGI with QCDs include:

1) Decreasing or eliminating the Medicare surtax (IRMAA)
2) Decreasing or eliminating the 3.8% Net Investment Income Tax (NIIT)
3) Improving the ability to take medical deductions
4) Reducing the marginal tax rate
5) Increasing the likelihood of deducting rental real estate losses

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Note: This is not intended to be, nor should it be construed or used as, tax advice. You should consult your professional tax advisors for advice specific to your situation.