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PLANNING INSIGHTS

Mastering the Art of Giving: The Strategic Advantage of Qualified Charitable Distributions

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In our over four decades as an RIA, we've seen a multitude of strategies to optimize wealth and tax positions. One of the most effective yet underutilized tools for those aged 70½ and above is the Qualified Charitable Distribution (QCD). QCDs present a unique opportunity to marry philanthropic desires with tax-efficient retirement planning.

This mechanism not only furthers philanthropic endeavors but also provides significant tax efficiencies, especially in the context of IRA distributions. Through this article, we will demystify QCDs, highlighting their tax advantages, common pitfalls to avoid, and the impact of recent tax reforms. For those seeking to align their retirement assets with charitable goals, understanding QCDs is essential. Let's delve into how these distributions can be a cornerstone in your financial and philanthropic strategy.

Understanding Qualified Charitable Distributions

A QCD is a direct transfer of funds from your IRA custodian, payable to a qualified charity. This option is available to IRA holders who have reached 70½ years of age, allowing for up to $105,000 *(2024)* per year to be transferred directly to eligible charities. This amount can satisfy all or part of your Required Minimum Distribution (RMD) for the year.

KEY POINTS:

- Eligibility: Available to individuals aged 70½ and older.
- Contribution Limit: Up to $105,000 *(2024)* per year. Per eligible taxpayer (must have their own IRA)
- Tax Treatment: Amounts donated via QCDs are excluded from your taxable income, unlike regular RMDs.

The Mechanics

When a QCD is executed, the amount transferred to the charity is excluded from your taxable income. This differs significantly from the typical RMDs, which are taxed as ordinary income. Notably, for QCDs to be counted against the current year's RMD, they must be completed by December 31st of that year.

Expanded Benefits of QCDs

The advantages of QCDs are multifaceted, primarily centering on tax efficiency and strategic philanthropy.

1. LOWERING AGI:

A reduced AGI can lead to lower taxes on Social Security benefits, decreased Medicare Part B and D premiums, and create Roth conversion and other planning opportunities.

2. BYPASSING ITEMIZATION:

Since QCDs reduce AGI directly, they offer a tax benefit even to those who take the standard deduction, which has become more common under the recent tax law changes.

3. STATE TAX BENEFITS:

In many states, a lower AGI can also mean reduced state income taxes.

4. AVOIDING DONATION CAPS:

Unlike regular charitable contributions, which are capped at a percentage of AGI, QCDs are not subject to these limits, allowing for more significant charitable contributions.

5. ESTATE PLANNING:

By reducing the size of your IRA, QCDs can potentially lower estate taxes, ensuring more of your legacy goes to your heirs and chosen charities.

6. INVESTMENT STRATEGY SYNERGY:

QCDs can be strategically combined with other investment decisions for those with diversified portfolios to optimize tax efficiency across all assets.

These expanded benefits underscore the importance of considering QCDs as a part of comprehensive tax planning and charitable giving strategies.

Common Pitfalls in Using QCDs

Despite their benefits, there are common mistakes we've seen retirees make with QCDs:

1. TIMING MISCALCULATIONS:

A frequent error is missing the year-end deadline for QCDs to count against that year's RMD. This can lead to unexpectedly high taxable income and a missed opportunity for charitable giving.

2. MISUNDERSTANDING ELIGIBILITY AND LIMITS:

Initiating QCDs before reaching 70½, or exceeding the $105,000 *(2024)* limit, can result in unfavorable tax consequences.

3. IMPROPER EXECUTION:

The QCD must be a direct transfer to the charity. Funds withdrawn by the IRA owner and then given to a charity do not qualify as a QCD.

4. NOT COORDINATING WITH RMDS:

To count against RMDs, QCDs must be among the first distributions taken in the year.

5. QCDS DO NOT COUNT TOWARDS ITEMIZED DEDUCTIONS. NO DOUBLE DIPPING!

6. QCDS ARE REPORTED ON 1099R AS NORMAL DISTRIBUTIONS

Make sure you let your CPA know the QCD has been executed. (It is on the taxpayer to keep proof of direct donation).

The Impact of Tax Code Changes on Itemization

Under the new tax codes, with many individuals opting for the higher standard deduction, traditional charitable contributions have become less tax-effective. However, QCDs remain advantageous as they directly reduce AGI and are beneficial regardless of itemization.

EXAMPLE:

Understanding the Tax Benefits

Consider Jane, a retiree with a $50,000 RMD and in the 22% tax bracket, planning a $20,000 donation.

Scenario 1: Standard Charitable Deduction

- **RMD**: $50,000 added to taxable income.
- **Donation**: $20,000 without itemizing deductions.
- **Tax Impact**: Taxes on full RMD, no donation benefit.

Scenario 2: Using a QCD

- **RMD**: $30,000 taxable ($20,000 as QCD).
- **Tax Impact**: Taxes on reduced income.
- **Savings**: 22% of $20,000 = $4,400.

Scenario 2 not only meets Jane's charitable goals but also saves her $4,400 in taxes.

Advanced Strategies with QCDs

For those with a strategic mindset, QCDs can be a component of a larger financial plan:

1) MULTI-YEAR PLANNING

Consider the timing of QCDs in the context of your overall tax situation. In years when your income might be lower, maximizing QCDs can be particularly beneficial.

2) BALANCING WITH OTHER INCOME SOURCES

If you have other income sources, such as pensions or rental income, integrating QCDs into your income stream can optimize your tax brackets and reduce AGI.

3) ESTATE PLANNING INTEGRATION

QCDs can be an effective tool in reducing the value of your taxable estate, thereby minimizing estate taxes and maximizing the value passed to your heirs and chosen charities.

Conclusion:

Qualified Charitable Distributions offer a unique opportunity for those over 70½ to align their IRA distributions with their philanthropic goals in a tax-efficient manner. Understanding and leveraging QCDs can lead to substantial tax savings and a more impactful charitable giving strategy. As with any complex financial strategy, it's prudent to consult with a financial advisor to ensure these approaches align with your overall financial and estate planning objectives. Remember, in the art of giving, strategic planning is key to maximizing impact for both yourself and the causes you support.

Please don't hesitate to reach out for a complementary second opinion on your gifting strategy.

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A graduate of Baylor University, Mike has more than 17 years of professional experience in the finance industry. He enjoys working with family-centric executives & entrepreneurs looking to create lasting legacies by helping them navigate the unique challenges success, wealth, and family entails. Mike and his family reside in Southlake, TX.

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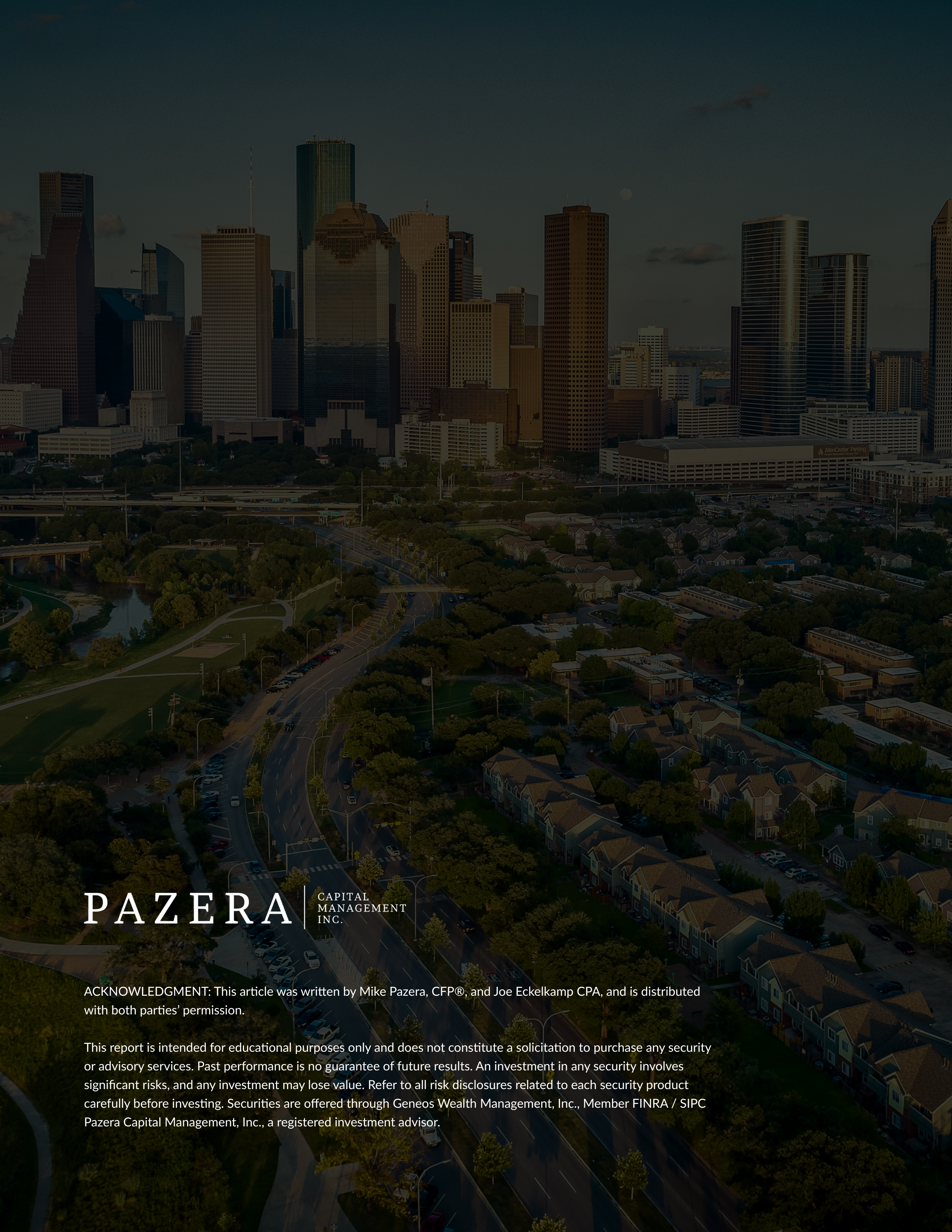

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