QCDs: Tax-Friendly Charitable Gifts

In most walks of life, you'd probably be pleased if you could accomplish two goals with one action. That's exactly what happens when you can turn some of your retirement funds into charitable gifts that support a worthy organization while also realizing tax benefits.

Here's a little background: If you haven't already withdrawn from your traditional IRA, you must do so once you reach 73, or 75 if you were born in 1960 or later. If you don't take these withdrawals — called required minimum distributions, or RMDs — or if you take too little, you will be subject to a possible 25% penalty on the amount not withdrawn. These RMDs can be sizable, and they're also taxable. But when you move money from your IRA to a qualified charitable organization — a process known as taking a qualified charitable distribution, or QCD — you can possibly satisfy your RMD requirement for that year, with the funds then being kept out of your taxable income. You don't even have to wait until you reach the RMD age because you can begin making QCDs of up to $105,000 per year once you reach 70½. (This amount is indexed for inflation, so it may rise each year.)

And because QCDs won't add to your taxable income, you can get additional benefits. First, by taking QCDs, rather than accepting the taxable income from your IRA, you could lower your adjusted gross income (AGI), which, in turn, could help reduce the taxes on your Social Security benefits. The taxes on these benefits are based on your overall income and filing status. And second, a lower AGI can possibly reduce your Medicare Part B premiums, which are also based on your income.

Now let's look at the relationship between two other retirement accounts and QCDs:

• *Traditional 401(k)* — A traditional 401(k), like a traditional IRA, will be subject to RMDs, but it doesn't qualify for a QCD. However, you could roll your RMDs from a 401(k) into an IRA, which would then let you use the QCD strategy. This rollover may be more beneficial to you than simply taking the distribution from your 401(k) and then donating the money to a charity, but you'll want to consult your tax professional.

• *Roth IRA* — A Roth IRA is not subject to RMDs, so you can essentially keep your IRA intact as long as you want, though you're likely to need at least some of it to help you pay for your retirement. But because Roth IRA withdrawals are tax-free (provided you've had your account at least five years and are 59½ or older before you take withdrawals), you won't get the benefit of lowering your AGI by transferring your IRA funds to a charity. Of course, you're still free to take money from your Roth IRA and donate it to charities. If you itemize on your taxes, you can deduct your charitable contributions, up to 60% of your AGI. But many people no longer itemize because of a significant increase in the standard deduction a few years ago.

If you don't need all the required withdrawals from your traditional IRA, you may find that taking a QCD is a good way to use the money. By helping a charitable group and getting tax benefits, you'll be "multitasking" in a way that benefits everybody.

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