How To Give Charitable Gifts - And Avoid Paying Tax - In 2018

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There was a ton of excitement about the new tax law passed at the end of 2017, especially in the business community. But the changes brought about by the law will certainly impact another area as well: charitable giving.

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First, a little tax speak: with the standard deduction doubling under the law, many individuals and couples will see fewer financial benefits because the standard deduction would be more than their itemized deduction, including things like charity and mortgage payments.

Consider an example of clients we have at Glassman Wealth: a retired couple in their 70s. They are fortunate in that they have a sizable retirement portfolio that generates significant annual income—more than six figures—which includes money they are required to take from their retirement funds starting at age 70.5, otherwise known as Required Minimum Distributions.

The couple also lives in Virginia, which has a modest income tax rate, and they own their home outright—which means they have no mortgage interest to deduct. They still do pay relatively high property taxes, and in the past, the couple has given roughly $5,000 in charitable gifts.

But this year, unless they encounter significant medical expenses (which total more than 7.5% of their total income), this couple will likely choose the standard deduction when they file their taxes in 2019. By doing so, that also means that they have no financial incentive to give to charity unless they give enough to push them above the $24,000 standard deduction threshold.

Will the new tax law hurt charities?

Most people give to make an impact, not for the financial incentive. And not all is lost under the new tax law, thanks to an often overlooked corner of the code.

This provision, which the IRS calls a Qualified Charitable Distribution, allows anyone aged 70.5 or older to donate money from their IRA account directly to a charitable organization without that gift counting as income. While Inherited IRAs are also eligible for a QCD, SIMPLE IRA plans and simplified employee pension (SEP) plans are excluded from this rule. There are also some restrictions on the types of charitable organizations that are eligible to receive a QCD.

If you or your spouse meet this age requirement, you can transfer up to $100,000 a year without paying any tax on that transaction. Even better, any money you transfer via one of these distributions reduces the amount you must take in required distributions. As an example, take a 75-year-old retiree whose RMD was calculated to be $50,000 for the year. She would normally take these funds and realize that income on her return. Instead, she may choose to make a $5,000 contribution to a qualified charity. In this case, $45,000 would appear as income on her return, thereby benefiting financially from her good deed.

A point worth noting: you may still transfer up to $100,000 a year even if your RMD is less than this amount. In the example above, the retiree’s annual RMD is $50,000. The QCD amount is not limited to $50,000, but rather $100,000 for the year. The amount in excess of the RMD is not treated any differently, for tax purposes (it does not count as income and you do not take an itemized deduction for the amounts).

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A further benefit of using this strategy is it helps reduce your Adjusted Gross Income (AGI). Your AGI determines how much of your Social Security is subject to income taxes, if you will be subject to the Net Investment Income Tax, and the amount of your Medicare premiums in the following year. So, lowering income can indirectly reduce other costs.

Of course, most who give to charity choose to spread their funds to several or more of their favorite charities. For example, annual charitable givings of $5,000 may break out as $3,000 to your favorite church or synagogue, $1,000 to the latest disaster relief, and $100 each to 10 other causes that you'd like to support.

Most brokerage firms will assist you with these transactions, only requiring that you provide the name, address, and other pertinent information for the charities. From there they will either disburse the checks directly to the charities, or send the checks to you to pass along. There are no IRS limitations on how many or how small the distributions may be to your favorite charities, so it only depends on your brokerage firm and any limitations they may have. (We checked with a couple of discount brokerage firms—they did not have any minimum amount per charity for QCD disbursements).

As many individuals now have a combination of ROTH and regular IRAs, it is worth noting that this is not a strategy for ROTH IRAs. While in certain circumstances, ROTH IRAs may be eligible for a QCD, it generally does not make sense as most distributions from ROTH IRAs are not taxable income. They also do not have required distributions during the owner's lifetime.

We'll be looking into other overlooked provisions of the tax code, and how you might be able to take advantage of them when it comes to your portfolio, in future posts.

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