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A tool to meet government's IRA tax rules but also boost to charities

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In the spirit of the holiday season - and the tax season that follows right after - some high-income senior citizens who can afford to donate money are using a loophole that allows them to make bigger charitable contributions.

The planning technique known as qualified charitable distributions is a way to beat the tax system, helping those who have reached the age of 70½ to make cash donations directly from their individual retirement accounts to IRS-approved charities.

Certified public accountants across the Pittsburgh region shared anecdotes about clients who have used this strategy. Green Tree accountant Alex Kindler has two, each donating the maximum $100,000 a year through qualified charitable distributions. But hard data on how much total money is donated this way locally or nationally is not readily available.

"I know that we encourage people to give through their required minimum distributions, but we do not track that information," said Kitty Julian, spokeswoman for The Pittsburgh Foundation.

This form of giving works perfectly for people who are at least 70½ years old because once owners of IRAs hit that magic age, they are required by law to start taking required minimum distributions - a set amount that must be withdrawn each year so they begin paying on the taxable portion of the withdrawals.

The required distribution for a given year can be taken out in a lump sum or in installments. The amount is determined by applying a life expectancy factor set by the Internal Revenue Service to the taxpayer's account balance at the end of the previous year.

For example, a 71-year-old taxpayer with an IRA account balance of $250,000 at the end of this year will be required to take out at least $9,433, according to the website Investor.gov.

"For most seniors taking a required minimum distribution from their IRA, the qualified charitable distribution will probably be their best method of making a charitable contribution," said James Lange, a Squirrel Hill-based tax accountant, attorney and author.

Qualified charitable distributions are not a new legislative creation. The loophole has been around for a while.

But it has become more popular since the 2017 Tax Cuts and Jobs Act nearly doubled the standard deduction amounts and practically eliminated the need for many taxpayers to itemize deductions like medical expenses and charitable donations.

The 2019 standard deduction for individuals rose to $12,200 for individuals, $24,000 for married filing jointly, and $27,000 if 65 and over. Prior to 2018, the standard deductions were about half this year's amount ($6,350 for individuals, $12,700 for married couples filing jointly and $15,200 for married couples who were both 65 and over).

"The qualified charitable distribution opened an opportunity for taxpayers to still get a deduction for charitable giving that they would have otherwise lost taking the standard deduction," said Matt Schwartz, an attorney at Lange Legal Group in Squirrel Hill.

A higher tax bracket

Funds invested in IRAs are allowed to grow tax-free over decades, as the owner saves up for the retirement years.

For the government, the idea behind required minimum distributions is to force the account owner to withdraw some of the money on an annual basis as taxable distributions while the owner is still

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alive. Otherwise, the account might avoid taxation altogether during the owner's lifetime and end up being passed to heirs.

"The higher your tax bracket, the more likely you are to be a candidate for this type of tax strategy," said Mr. Kindler, a partner at H2R CPA in Green Tree.

It doesn't actually put more money in the taxpayer's pocket, he noted, but it does mean more money for the charity involved.

He provided an example: If someone's required minimum distribution was $100,000 and that person was in the top 37% tax bracket, they would have only $63,000 left for the charity after paying taxes.

But if the account owner did a qualified charitable distribution from the IRA, the charity would get the entire $100,000 and the account owner would pay no taxes.

"That's great for the charity," Mr. Kindler said. "It helps the taxpayer feel good about giving $100,000 instead of giving $63,000. It's not a financial benefit for the taxpayer. It's an altruistic one. You get to be more charitable by doing it."

Charitable organizations here and across the country actively solicit donations from IRAs.

A website created by the Humane Society of the U.S. encourages people 70½ or older to give. "You can give up to $100,000 from your IRA directly to a qualified charity such as ours without having to pay income taxes on the money," the Humane Society's website said.

Deadline approaching

No matter if seniors 70½ or older plan to use their retirement funds for charitable contributions or not, time is running out to meet the Dec. 31 deadline to withdraw money from the accounts.

IRA owners must take their first required minimum distribution for the year in which the account owner turns 70½. However, the first payment can be delayed until April 1 of the year following the year the senior turns 70½. For all subsequent years, account owners must make the required minimum distribution by Dec. 31 of the year.

The penalty for not meeting the deadline is steep. For every dollar not withdrawn, the IRS will charge a 50% penalty tax.

Allianz Life Insurance Company of North America recently completed a study that found 83% of seniors hate paying taxes on their required minimum distributions.

"They fear that their required minimum distribution payments will put them in a higher tax bracket and they'll end up paying more taxes overall," said Kelly LaVigne, vice president of advanced markets at the Minneapolis-based company.

Mr. LaVigne added that seniors also have a belief that retirees should not be required to take payments at a predetermined age.

"Oftentimes required minimum distributions actually end up being more than what people need, so they are forced to take out money at a higher tax rate, which can be an unexpected burden."

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