IRAs, RMDs, and Charities

For years, many of us have done the right thing . . . we've saved! We have accumulated funds for our future needs through sound investments and conservative lifestyles. To further compound those savings, we have taken advantage of tax-free growth inside Individual Retirement Accounts (IRAs). In many cases, those IRAs end up holding more than is actually needed. It is estimated that Americans now have over $2.5 trillion working for them in IRAs. Unfortunately, distributions from these IRAs are subject to income taxes. Recent legislation, however, can help alleviate this tax burden for some of us that are charitably inclined.

The Protecting Americans from Tax Hikes (PATH) Act of 2015 (hereinafter referred to as the "Act") allows tax free distributions to be made directly from certain IRAs for charitable purposes. Now an IRA holder who is 70 ½ or older at the time of the gift, may directly transfer up to $100,000, per year, from IRA holdings to a charitable organization. It is important the IRA custodian transfer the funds directly to the charitable organization, and that the charitable recipient is an actual, operating charity described under Internal Revenue Code §170(b) (1) (A). Private foundations, supporting organizations, or donor advised funds do not qualify.

Prior to the Act, funds withdrawn from an IRA were reported as taxable income for the year of withdrawal, even if the entire amount was subsequently donated to charity. Under some circumstances, the resulting deduction did not always equal the increase in taxable income. Any amount donated as a qualified charitable distribution is not included in the donor's taxable income, but this type of distribution does count towards the donor's RMD. Although the donor is not entitled to a charitable deduction, they potentially receive a better income tax result by making a charitable distribution in this manner.

For example, a qualified charitable distribution of $70,000 would satisfy a client's RMD for the year that is less than or equal to that amount. And because the donor's taxable income is not increased by that amount, potentially less of their social security income may be subject to tax and fewer of their deductions or exemptions may be phased out.

Clients who have been building up large amounts in their IRAs with the intention of holding as much as possible in those accounts until death, passing them to children, and avoiding the income tax during their lives (but ensuring it for their kids!) now have an avenue of making a charitable social impact, as well as potentially reducing overall income and estate taxes (if applicable). Please contact one of the estate planners for advice on how to utilize this tax saving strategy before this year ends!

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