



COMMITTEE REPORT: RETIREMENT BENEFITS

By **Christopher R. Hoyt**

A Wake-up Call to Senior Clients

Start making all your charitable gifts from your IRAs

The number of income tax returns that will report income tax savings from charitable donations is projected to plummet from 37 million in 2017 to just 16 million in 2018.¹ The staggering decline of 21 million returns is due principally to two changes in the Tax Cut and Jobs Act of 2017: (1) limiting the itemized tax deduction for state and local taxes to \$10,000 per return (\$5,000 for married taxpayers filing separately), and (2) increasing the standard deduction to \$12,000 on single returns, \$24,000 on married-joint returns and \$18,000 on head-of-household returns—with even higher thresholds for individuals over age 65.²

“A Massive Conversion,” p. x, illustrates how these changes will cause millions of itemizers to convert into non-itemizers. It demonstrates the outcome for a taxpayer who pays \$20,000 of state and local taxes and who pays a combination of \$5,000 of mortgage interest and charitable gifts. Among households with incomes between \$86,000 and \$150,000, the percentage of tax returns that will report itemized deductions is projected to fall from 39 percent to just 15 percent.³

For individuals over the age of 70 ½, the good news is that no change was made to the law that permits them to make charitable gifts from their individual retirement accounts without recognizing taxable income. These individuals are therefore still able to get income tax savings from their charitable gifts. They can, for example, make charitable gifts from their IRAs and apply those gifts to satisfy their required

minimum distribution obligation for the year, yet pay no income tax on those charitable IRA distributions.⁴

There are hundreds of thousands of individuals over age 70 ½ who’ve never before taken advantage of this law. They saw little point in making charitable gifts from their IRAs because they were able to get tax savings by claiming itemized tax deductions for their charitable gifts. Please allow this article to serve as a wake-up call. Determine whether your client will be able to itemize her tax deductions in 2018. If not, then she should immediately stop making charitable gifts the way that she has in the past. Instead, she should start using her IRA to make all of her future charitable gifts.

Mechanics

The law (commonly referred to as a “charitable IRA rollover”) permits individuals over the age of 70 ½ to make charitable gifts directly from their IRAs to eligible charities and exclude the distributions from their gross income. “Nine Requirements,” p. x, specifies the legal requirements. The price: There’s no itemized charitable income tax deduction for such an IRA gift. Of course, if the taxpayer isn’t able to itemize income tax deductions, then there’s no price to pay.

Taxpayers who used to itemize their deductions but no longer can, should (in theory) make every charitable gift from their IRAs. IRA administrators should expect a surge of requests in 2018 compared to prior years. The primary obstacle is the practical impediment of making numerous small gifts—for example, \$20 or \$50—from an IRA. One practical solution is an “IRA checkbook” offered at some brokerage houses, where each check is a distribution from the IRA. By having the IRA account owner write a check for any dollar amount and then mailing the IRA check to the



Christopher R. Hoyt is a professor of law at University of Missouri (Kansas City) School of Law in Kansas City, Mo.



Nine Requirements

What's needed for a qualified charitable distribution

An individual over age 70½ who makes a qualified charitable distribution (QCD) from her individual retirement account:

- (1) will not report the distribution as taxable income,¹ and
- (2) will not be entitled to claim a charitable income tax deduction for the gift.²

If an IRA gift fails any one of the requirements listed below, then the distribution should be reported as a taxable distribution, and the donor can attempt to claim an offsetting itemized charitable income tax deduction.³

Legal Requirements for a QCD

1. Donor must be at least age 70½.⁴
2. IRAs only—not 401(k) plans or 403(b) plans.⁵
3. The charitable distribution must be made directly from the IRA to the charity.⁶ This is usually satisfied by having the check issued in the name of the charity.
4. The recipient organization must be a public charity, a private operating foundation or another special type of private foundation (PF).⁷ The three ineligible charitable recipients are: non-operating (grantmaking) PFs, donor-advised funds and Section Internal Revenue Code Section 509(a)(3) supporting organizations.⁸
5. The payment would otherwise fully qualify for a full charitable income tax deduction.⁹ There can be no personal financial benefit to the donor that would reduce a charitable income tax deduction (for example, auction purchases, fundraising dinners, favorable seating at athletic events or any other type of quid pro quo transaction).
6. The favorable tax treatment only applies to the taxable portion of an IRA distribution.¹⁰
7. The maximum exclusion is \$100,000 per year.¹¹ For married individuals filing a joint return, the limit is \$100,000 per individual IRA owner, for a maximum exclusion of \$200,000 on a joint return.¹²
8. The donor must have documentation from the charity that would qualify the gift for a full charitable income tax deduction under normal circumstances.¹³ The IRA account owner must receive a contemporary written acknowledgment (CWA) from the charity before filing his income tax return. The CWA should describe the amount of cash contributed and certify that the donor didn't receive any goods or services in exchange for the gift.¹⁴ Although there's no legal requirement that the CWA state that the gift was made from an IRA, such a statement is often very helpful. Some taxpayers simply give all of their charitable receipts to their accountants. A reference to an IRA alerts the accountant to the fact that the gift qualifies for the favorable charitable IRA exclusion treatment and isn't an itemized charitable tax deduction.
9. The taxpayer should report the IRA exclusion on the front page of Form 1040, with a reference to a qualified charitable distribution (QCD).¹⁵

Endnotes

1. Internal Revenue Code Section 408(d)(8)(A).
2. IRC Section 408(d)(8)(E).
3. Internal Revenue Service Notice 2007-7; 2007-5 IRB 1, Q&A 43.
4. Section 408(d)(8)(B)(ii).
5. Section 408(d)(8)(B). The one exception is a grant from an individual retirement ac-

- count that's part of an ongoing simplified employee pension (SEP) or an ongoing savings incentive match plan for employees (SIMPLE) (that is, a SEP or SIMPLE contribution was made to that IRA that same year). IRS Notice 2007-7; 2007-5 IRB 1, Q&A 36.
6. Section 408(d)(8)(B)(ii). The check from the IRA must be issued payable to the charity. The check doesn't have to be mailed to the charity by the IRA administrator. Instead, the check can be mailed to the IRA account owner who can then forward the check to the charity. IRS Notice 2007-7; 2007-5 IRB 1, Q&A 41.
7. Section 408(d)(8)(B)(i) provides that the recipient organization must be described in Section 170(b)(1)(A), which includes all "public charities." However, certain private foundations (PFs) are also included in Section 170(b)(1)(A) and should therefore be eligible for gifts from IRAs. Private operating foundations are described in Sections 170(b)(1)(A)(vii) and 170(b)(1)(E)(i). Conduit PFs are described in Sections 170(b)(1)(A)(vii) and 170(b)(1)(E)(ii). Donor directed funds are described in Sections 170(b)(1)(A)(vii) and 170(b)(1)(E)(iii).
8. Although gifts to a donor-advised fund or to a Section 509(a)(3) supporting organization qualify as gifts to a public charity under Section 170(b)(1)(A), Section 408(d)(8)(B)(i) specifically provides that they aren't eligible for the favorable charitable IRA rollover treatment.
9. Section 408(d)(8)(C).
10. Section 408(d)(8)(B) (last sentence). Most IRA distributions are 100 percent taxable. However, if an IRA owner made any nondeductible contributions to the IRA, then the portion of a distribution that represents a return of the nondeductible contribution is normally tax-free. A QCD only applies to the taxable portion. The charitable IRA rollover law has a very favorable formula that presumes distributions are fully taxable, thereby leaving the maximum amount of tax-free dollars in the IRA. Section 408(d)(8)(D). See also Example 2 of Technical Explanation Of H.R. 4, The Pension Protection Act of 2006, prepared by the Staff of the Joint Committee On Taxation Aug. 3, 2006 (JCY-38-06) on p. 268.
11. Section 408(d)(8)(A).
12. IRS Notice 2007-7; 2007-5 IRB 1, Q&A 34.
13. "The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution." (Emphasis added). Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," Joint Committee on Taxation, JCY-38-06 (Aug. 3, 2006) at p. 267. In addition to making the IRA distribution taxable, failure to obtain such an acknowledgment could also cause the loss of any offsetting charitable income tax deduction.
14. Section 170(f)(8), for gifts of \$250 or more. For a contribution from an IRA to qualify for the favorable tax treatment, there can't be any such benefit to the donor. Section 408(d)(8)(C).
15. The total of all IRA distributions from Form 1099-R are reported on Line 15a of Form 1040, but only the taxable distributions are reported on Line 15b. The taxpayer should insert the letters "QCD" next to Line 15b. See Form 1040 Instructions for 2017, at pp. 25 and 26; Lines 15a and 15b—IRA Distributions—Exception 3 (qualified charitable distribution (QCD)). The QCD reference serves as an explanation of why not all of the IRA distributions were taxable. There's no code on Form 1099-R for the IRA administrator to report to the IRS the eligible charitable distributions.

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A Massive Conversion

A decrease in the number of households that itemize deductions

| Non-itemizer in 2017 - Situation in 2018 | | | | |
|--|------------|----------|-------------------------------|----------|
| | Single (S) | | Married (M) With Two Children | |
| | 2017 | 2018 | 2017 | 2018 |
| Adjusted gross income (AGI) | S - AGI | S - AGI | M-AGI | M-AGI |
| Standard deduction | \$6,350 | \$12,000 | \$12,700 | \$24,000 |
| Personal exemption and dependents | \$4,050 | 0 | \$16,200 | \$0 |
| = Taxable Income (TI) | S - TI | S - TI | M - TI | M - TI |

Itemizer in 2017 - Situation in 2018 : Assume taxpayer pays \$20,000 of state and local taxes each year and pays a combined total of \$5,000 of mortgage interest and charitable gifts. In 2018, only \$10,000 of the state and local taxes may be deducted, so itemized deductions in 2018 only total \$15,000.

| Non-itemizer in 2017 - Situation in 2018 | | | | |
|--|------------|--------|-------------------------------|----------------------|
| | Single (S) | | Married (M) With Two Children | |
| | 2017 | 2018 | 2017 | 2018 |
| AGI | M-AGI | S-AGI | M-AGI | M-AGI |
| Itemized deductions | 25,000 | 15,000 | 25,000 | 24,000 |
| | | | | * Standard deduction |
| Personal exemption and dependents | 4,050 | 0 | 16,200 | 0 |
| = TI | S - TI | S - TI | M - TI | M - TI |

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charity, the IRA checkbook alleviates the administrative burden that would otherwise be imposed on the IRA administrator.

Bunching Charitable Gifts

For taxpayers under the age of 70 ½, a strategy to be able to itemize charitable deductions is to “bunch” several years of tax deductions into selected years. For example, someone who donates \$5,000 per year to charities might donate a total of \$15,000 in one year and nothing in the next two years. The large amount of charitable gifts might permit the taxpayer to itemize tax deductions that year, thereby generating tax savings that year from the charitable gifts, and then take the standard deduction in the next two years.

Such a strategy, of course, throws havoc into the

cash-flow projections of the charities. Consequently, the best way to accomplish this strategy is to make the bunched gifts to a private foundation (PF) or a donor-advised fund (DAF). The PF or DAF can then make distributions each year to the charities. The Internal Revenue Service now permits DAFs (but not PFs) to satisfy legally binding pledges. Thus, a donor can make pledges to the charities and use the bunched giving strategy to satisfy those pledges.

The Bottom Line

Time will tell whether, and by how much, the loss of itemized tax deductions might reduce the amount of charitable gifts received by the nation's charities. But there's one very large group of donors who still have the ability to get income tax savings from all of the charitable gifts that they



make: seniors over the age of 70 ½ who have IRAs. 

Endnotes

1. Howard Gleckman, “21 Million Taxpayers Will Stop Taking the Charitable Deduction Under The TCJA,” The Tax Policy Center of The Urban Institute and The Brookings Institution (Jan. 8, 2018), <http://www.taxpolicycenter.org/tax-vox/21-million-taxpayers-will-stop-taking-charitable-deduction-under-tcja>.
2. The additional standard deduction for someone who is age 65 or older is \$1,300 for each married taxpayer or \$1,600 for an unmarried taxpayer.
3. Gleckman, *supra* note 1.
4. Internal Revenue Service Notice 2007-7; Q&A 42 provides that a qualified charitable distribution can be applied to satisfy the annual required minimum distribution requirement.
5. IRS Notice 2017-73.