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White paper

Charitable IRA distributions

An opportunity for both charities and life insurance

Steve Hamilton, JD, CLU®, ChFC®
Director, Advanced Consulting Group

Section 408(d)(8) IRC permits qualifying charitable distributions (QCD) from traditional IRA accounts to be excluded from gross income. The provision first appeared in the Pension Protection Act in August 2006, as a temporary measure. In the intervening years, it lapsed and was revived several times. The Protecting Americans from Tax Hikes (PATH) Act of 2015 made it permanent. It is a powerful incentive to charitable giving, and the gift can be magnified with life insurance.

Requirements to be a qualifying charitable distribution

The requirements are relatively simple. The distribution must be:

- From a traditional IRA,
- Direct, from the IRA trustee to the charitable organization — no intervening possession or ownership by the IRA owner,
- On or after the IRA owner has achieved the age of 70½,
- A contribution to an organization would qualify for a charitable contribution deduction under Section 170 IRC, the Code section covering contributions deductible as itemized deductions.

Tax benefits of charitable IRA distributions

There are several tax benefits to charitable IRA distributions, some not readily apparent.

Percentage of Adjusted Gross Income (AGI) limitation

Under the standard IRA distribution rules, if a donor takes $100,000 out of an IRA and gives it to a charity, the $100,000 first must be included in gross income. Then the donor gets a charitable contribution itemized deduction. The possible problem is that the donor's $100,000 contribution deduction will run into the 60% of Adjusted Gross Income (AGI) limitation. That means it is possible that the donor will not be able to deduct the full $100,000 in the year of contribution. That will force the donor to pay income tax on the difference between the $100,000 and the deductible amount. Carryover provisions allow the excess contributions to be carried forward for five years. But still, the donor would have to prepay some income tax (possibly a lot) and take his or her chances with being able to recover the prepayment in future years.

A §408(d)(8) charitable IRA distribution completely avoids that issue. By excluding the $100,000 from gross income, in effect the donor gets a $100,000 charitable contribution deduction — since the $100,000 isn't included in income it is, effectively, deducted.

Standard deduction

Someone who takes the standard deduction does so because their itemized deductions aren't large enough. Therefore, the standard deduction is more beneficial to them than itemizing. Because the QCD completely avoids the inclusion of the IRA distribution as income, the donor, can effectively get both the standard deduction and the charitable contribution deduction.

Taxability of Social Security

An increase in an individual's "provisional income" (§86 IRC, sort of a modified AGI) may make more of the individual's Social Security benefit subject to income tax. By not being included in AGI, the charitable rollover will not be included in provisional income, avoiding the possibility that the charitable rollover would increase the amount of Social Security subject to income tax.

State income taxes

Some states do not allow deductions for charitable contributions. Therefore, the charitable rollover provisions avoid a possible increase in the donor's state income tax.

Required Minimum Distribution (RMD)

The charitable rollover is included in determining whether the RMD has been made. Therefore, if the RMD was $60,000, a $100,000 distribution would satisfy the requirement for that year. Unfortunately, the excess $40,000 cannot be carried over to later years to help satisfy those years' RMD requirements.

Spouses

The provision applies to each individual's IRAs. In a marriage, it's possible that both spouses will have IRAs. Therefore, it's possible that the spouses could team up, each rolling over $100,000 for a $200,000 rollover contribution to a single qualified charity or several charities.

Annual limit

The $100,000 is an annual limit. Therefore, a donor could do it every year.

And finally

To reiterate, the Charitable IRA Distribution is no longer a temporary, expiring, measure, which can allow for longer term charitable distribution arrangements and plans.

Conclusion

All of the above are potential tax benefits made possible by the charitable IRA distribution.

Magnifying with life insurance

If the charity and the donor cooperate, the distribution can be magnified using life insurance. To be clear, the charity would be the purchaser, owner and beneficiary of the contracy.

Consider the following examples:

- 71-year-old male, standard nontobacco, Nationwide YourLife® No Lapse Guarantee UL. A $100,000 single premium will generate a $137,300 policy benefit.
- 71-year-old female, standard nontobacco, Nationwide YourLife No Lapse Guarantee UL. A $100,000 single premium will generate a $162,190 policy benefit.
- 71-year-old male & female, standard nontobacco, Nationwide YourLife No Lapse Guarantee Survivor UL II. One $200,000 premium, $100,000 from each person's IRA will generate a $378,760 policy benefit.

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