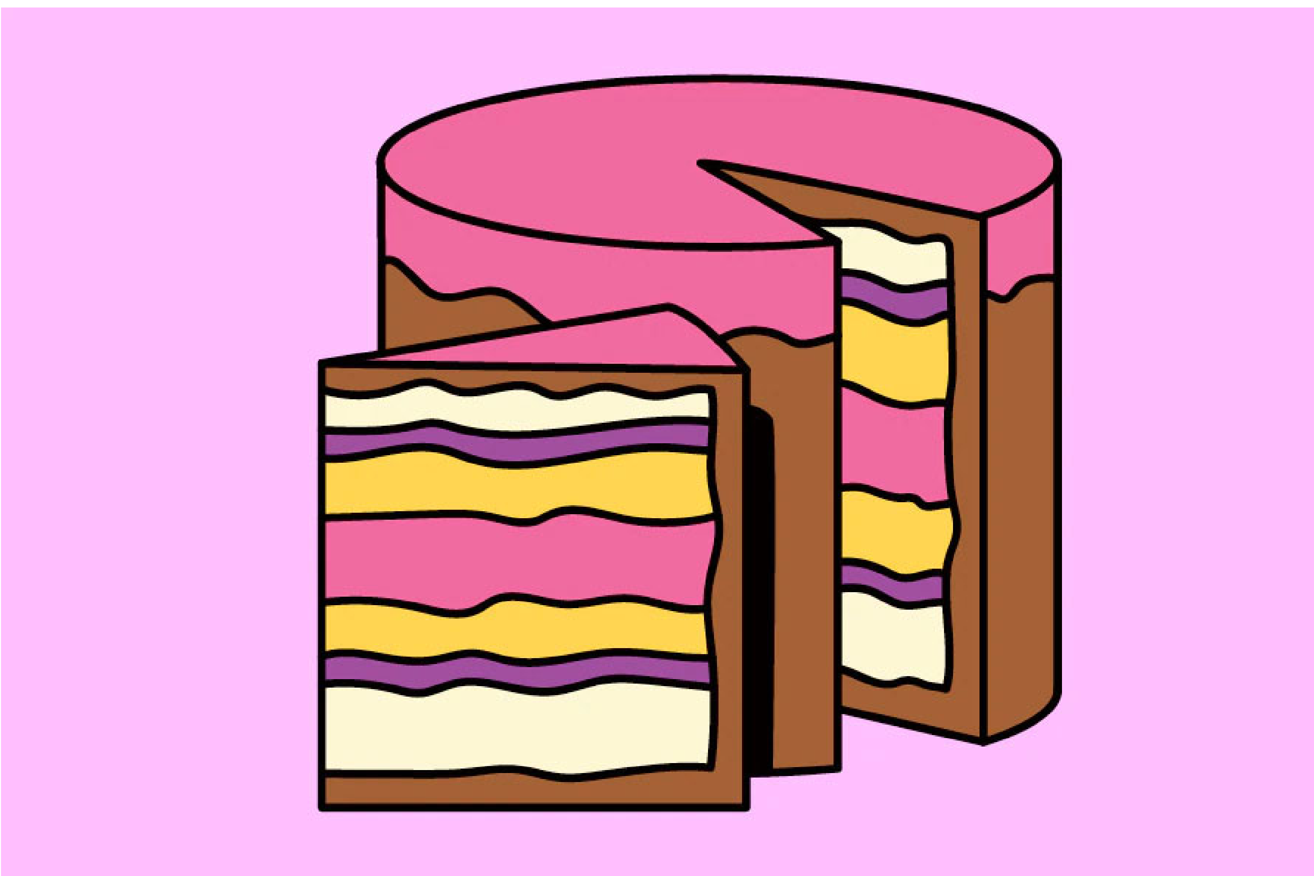
RETIREMENT >

Reducing RMDs with QCDs

November 10, 2022

A QCD can be a great way to reduce RMDs and optimize the tax benefits of giving.



For retirees who've accumulated significant savings in their tax-deferred accounts, the onset of required minimum distributions (RMDs) at age 72 can have serious tax consequences. "The higher the balance in your tax-deferred accounts, the higher your RMDs—and potentially your tax bracket," says Hayden Adams, CPA, CFP®, director of tax and financial planning at the Schwab Center for Financial Research.

If charitable giving is part of your financial plan, a qualified charitable distribution (QCD) can further your philanthropic goals *and* help reduce the tax hit from RMDs.

QCDs allow individuals age 70½ and older to make tax-free donations of up to $100,000 a year directly from an IRA to a qualified charity, thereby satisfying all or part of their annual RMDs. "QCDs don't count as income—meaning you can't deduct the contribution on your tax return—but their tax benefits could outweigh those of donating cash or other assets to charity," Hayden says.

For example, let's say you're 75 years old, single, and need $125,000 in income this year. You're required to withdraw $110,000 in RMDs and will receive another $50,000 of taxable income from a pension and Social Security—pushing your total taxable income to $160,000. By making a QCD equal to your excess income ($35,000), you could potentially pay $3,420 less in taxes than if you took the full RMD and donated the cash after the fact (see "Cash vs. QCD," below).

Cash vs. QCD

Taking your full RMD and then donating cash could result in a higher tax bill than if you were to give through a QCD.

Scenario 1

Take full RMD and donate $35,000 in cash

Nonportfolio income: $50,000

Annual RMD: + $110,000

QCD: $0

Pretax income: = **$160,000**

Itemized deduction: – $35,000

Taxable income: = **$125,000**

Estimated taxes due: $24,021

Scenario 2

Donate $35,000 of RMD directly to charity using a QCD

Nonportfolio income: $50,000

Annual RMD: + $110,000

QCD: – $35,000

Pretax income: = **$125,000**

Itemized deduction: – $14,250

Taxable income: = **$110,750**

Estimated taxes due: $20,601

Note: RMD amount is approximate and assumes an IRA balance of $2.5 million. Tax calculations are estimated using 2021 federal tax brackets, do not reflect state taxes, and assume that 85% of Social Security benefits are taxable. In 2021, the standard deduction for individuals ages 65 and older is $1,700 more than the standard deduction for those younger than 65.

“That said, you don’t necessarily want to give away money just to get a tax break,” Hayden says. “But if philanthropy is already part of your financial plan, a QCD can be a great way to optimize the tax benefits of giving.”

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