How to Reduce Your Taxes and AGI by Giving to Charity

By [MARK P. CUSSEN](https://www.investopedia.com/contributors/186/)

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Required minimum distributions from IRAs can be a drag for many a taxpayer, uncomfortably boosting his annual income, sometimes even into a higher bracket. But there's a way to do good with the RMD, both for others and for one's own bottom line. In 2015, Congress made permanent the qualified charitable distribution (QCD) rule. This rule allows traditional [IRA](https://www.investopedia.com/terms/i/ira.asp) owners to exclude their required minimum distributions (RMDs) from their adjusted gross income if they give the money to a qualified charitable organization.

Given the impact RMDs can have on one's tax bill, it's worth creating long-term planning strategies around this rule.

KEY TAKEAWAYS

* The qualified charitable distribution (QCD) rule allows traditional IRA owners to deduct their required minimum distributions on their tax returns if they give the money to a charity.
* By lowering your adjusted gross income, the QCD rule can effectively reduce your income taxes.
* QCDs are capped at $100,000 annually, per person.
* QCDs must be made directly to the charity.

Who Can Use the QCD Rule

Any traditional IRA owner or beneficiary who is at least 70½ years old can use the qualified charitable distribution (QCD) rule to exempt their [required minimum distributions](https://www.investopedia.com/terms/r/requiredminimumdistribution.asp) (RMDs) from taxation. The age limit here applies to the exact date on which the IRA owner turns age 70½. For example, if an IRA owner turns 70 on February 15, he or she cannot make a QCD until August 15.

[Roth IRA](https://www.investopedia.com/terms/r/rothira.asp) owners are also allowed to use the QCD rule, although they will not see any benefit from doing so as their distributions are already tax-free.

Eligible Distributions

All contributions and earnings that accumulate inside a traditional IRA are eligible for QCDs. The exception is nondeductible contributions, as they are considered a tax-free return of basis.

The amount that can be taken as a QCD is capped at $100,000 per taxpayer per year.

Joint gifting strategies are also not available for the purpose of QCDs, meaning a couple cannot take both of their aggregate RMD amounts from a single account and exclude the entire amount from their [adjusted gross income](https://www.investopedia.com/terms/a/agi.asp) (AGI). Each of them must take their RMD from their own accounts for both to qualify.

The QCD strategy can also benefit traditional IRA owners who want to convert their balances to Roth accounts, as the QCD will reduce the amount of taxable money in the account.

The AGI Advantage

One of the biggest advantages the QCD rule provides is the ability for taxpayers to lower their [adjusted gross income (AGI)](https://www.investopedia.com/terms/a/agi.asp). This is much more valuable than taking an [itemized deduction](https://www.investopedia.com/terms/i/itemizeddeduction.asp), which merely lowers taxable income. Because AGI is used for many tax calculations, having a lower number can allow the donor to stay in a lower tax bracket, reduce or eliminate the taxation of Social Security or other income, and remain eligible for deductions and credits that might be lost if the taxpayer had to declare the RMD amount as income.

Payout Rules

The main rule to remember when it comes to QCDs is the distributions must be made directly to the charity, not to the owner or [beneficiary](https://www.investopedia.com/terms/b/beneficiary.asp). This means, have the distribution check made out to the charity or it will be counted as a taxable distribution. The IRA owner or beneficiary can receive this check and deliver it to the organization, but he or she cannot deposit the check and make out another one to the charity.

The IRA owner can, of course, take a sum larger than his or her RMD and give it to the charity. Remember that $100,000 cap, though. Any distributions in excess of $100,000 will not be excluded from AGI, and the taxpayer must qualify for itemized deductions to deduct the excess contribution.

The receiving charity must also be a qualified 501(c)3 organization. Vehicles such as charitable gift annuities will not qualify.

Finally, the donation amount must also be substantiated by the charity with a written receipt.

***The SECURE Act, passed in late 2019, increased the age at which IRA owners must begin required minimum distributions to 72; however, the age for qualified charitable distributions remains age 70½, creating a unique one-to-two-year window in which IRA distributions qualify as charitable contributions, but not as RMDs.***

The Bottom Line

IRA owners who wish to lower their AGI can use the qualified charitable distribution strategy to efficiently disperse money to a charity of their choice. This strategy is superior to taking constructive receipt of the distribution and then donating to charity because the second option will not reduce the donor’s AGI. If used properly, the QCD rule will provide charitably minded IRA owners with a convenient tax deduction for years to come.