Natalie B. Choate, Esq.: Magic Age is 70½
Heckerling 2018 Outline–Update for Tax Cuts and Jobs Act

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The Magic Age is 70½

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Update of Heckerling Presentation Outline for the Tax Cuts and Jobs Act

This Update contains updated sections of the original outline that are changed as a result of the Tax Cuts and Jobs Act (TCJA). **Outline sections that were NOT affected by the TCJA are not reproduced here.**

The TCJA made few direct changes to the rules discussed in the original “Magic Age” Outline. The primary direct change was to eliminate the option to undo or reverse (“recharacterize”) a Roth IRA conversion; for details on that change, see the TCJA Update to the author’s other Heckerling 2018 Outline, “Doth Thou Roth?” Some other changes predicted in “Appendix C” of the original “Magic Age” Outline did not come to pass; see revised Appendix C at the end of this Update.

The TCJA changed income and transfer tax rates and/or deductions/exemptions for most people. For information about those changes, please seek other sources. Those changes have a general indirect effect on planning for required minimum distributions, but otherwise had no effect on the statements in this Outline except those noted below.

**PART A: 70½: THE NONPROFESSIONAL’S GUIDE TO RMDS**

**TCJA UPDATE:** The TCJA made no direct changes to “Part A.” Most significantly, the TCJA made NO CHANGES to the minimum distribution rules. For example, the TCJA did not impose a requirement of lifetime RMDs on Roth IRAs, although some have been expecting such a change in the law to occur. As before, Roth IRAs continue to have no required minimum distributions during the lifetime of the original owner. The following minor indirect changes should be noted:

**Second Section: Five Ways to Reduce Your RMDs**

**TCJA UPDATE:** Though the TCJA made no direct changes to the rules on qualified charitable distributions (QCDs), its other changes to the Code have an indirect effect, requiring “Chapter 8” of the “Nonprofessional’s Guide” to be restated as follows. Changes are highlighted by boldface type or strikeout.

**CHAPTER 8 [Restated for TCJA]**

**Qualified Charitable Distributions from Your IRA**

*How a QCD works; how it can benefit you*

An over-age-70½ IRA owner can, in any calendar year, instruct the administrator of the IRA to transfer up to $100,000 directly from the IRA to one or more eligible charities. The amount so transferred is not includible in the gross income of the IRA owner-donor, even though it is a distribution from his or her IRA, and even though it counts towards the required minimum distribution.

Here is why this is a more tax-effective way to give to charity than simply taking a distribution from the IRA, then donating the distributed amount to charity. A normal IRA distribution is includible in the IRA owner’s gross income for federal income tax purposes, thus increasing his or her “adjusted gross income” (AGI). A normal charitable contribution generates an “itemized deduction” for the contribution amount—but an itemized deduction *does not reduce AGI.*

The QCD bypasses the IRA owner’s tax return altogether. Accordingly, a QCD does *not* increase AGI. It is a way to fulfill your RMD requirement without increasing your AGI.

Having a higher AGI can increase your income taxes and Medicare premiums. Having a lower AGI can lower those costs. Here’s a list of specific taxes and costs you may reduce or avoid by having a lower AGI as a result of satisfying your RMD with a QCD rather than by means of an income-includible distribution from your IRA (based on 2017 rates), with citation to the applicable section of the Internal Revenue Code:

✓ An individual becomes subject to the 3.8% additional income tax on “net investment income” if his AGI is above certain levels. § 1411.
Medical expenses are deductible only to the extent they exceed 10% (for years 2018–2025) of AGI. § 213(a).

Miscellaneous itemized deductions (such as investment expenses and tax preparation costs) are deductible only to the extent they exceed 2% of AGI. § 67(a). For the years 2018–2025, “miscellaneous itemized deductions” are nondeductible for individuals.

Itemized deductions are reduced (i.e. become partially not deductible) if the individual’s AGI exceeds a certain level. § 68(a). § 68(a) is “repealed” for the years 2018–2025; there is no longer a reduction of itemized deductions for high-income taxpayers.

Social Security benefits may be wholly or mostly excludible from an individual’s gross income, or mostly includible in gross income, depending on the level of the individual’s AGI. § 86.

The QCD does not count for purposes of the percentage-of-income limits on charitable deductions in § 170(b).

A QCD is in effect “deductible” even for someone who does not itemize deductions: The IRA owner can satisfy his charitable gifts with a QCD, exclude the distribution from his income, and still take the standard deduction against his other income on his tax return. The increase in the “standard deduction” as a result of TCJA, coupled with the cutback of some other itemized deductions, will probably make this advantage relevant to more people.

Morgan and Poppy Example: Morgan, age 72, and Poppy, age 68, are husband and wife. Their only itemized deductions are state taxes ($10,000) and their annual $15,000 gift to charity. Morgan’s RMD from his IRA is $10,000. Under TCJA, they are entitled to a standard deduction of $24,000 (for married couples filing jointly) plus $2,600 (two $1,300 exemptions because each is over age 65), total $26,600. If Morgan takes his RMD in cash from the IRA, it will generate $10,000 of gross income. They will get no benefit from their itemized deductions because the total of their itemized deductions ($25,000) is lower than their standard deduction ($26,600)...plus they have $10,000 of additional gross income. Instead, Morgan makes the annual $15,000 charitable gift from his IRA in the form of a QCD. This reduces his gross income by $10,000 compared to what it would otherwise have been, and they still get the $26,600 standard deduction to offset against their other income.

Finally, Medicare premiums are higher for higher-income individuals. The determination of “income” for this purpose is based on the individual’s AGI for the year two years prior to the premium year in question. 42 U.S. Code §1395r(I)). Thus, by keeping the RMD out of AGI through a QCD (sorry about all these abbreviations), the IRA owner may keep Medicare premiums lower (two years later) for both the IRA owner and his or her spouse.

Darla Example: Darla is age 73. In 2016 her RMD was $140,000. She took $120,000 of this in cash and made a $20,000 qualified charitable distribution (QCD) to fulfill the rest of her RMD. She files a joint income tax return with her husband Godfrey. Their AGI for 2016 was $290,000. If Darla had taken her entire 2016 RMD in cash, their AGI would have been $310,000 instead of $290,000. This would have put Darla and Godfrey into another, higher, bracket level for purposes of determining their Medicare premiums in 2018, increasing their combined Medicare premiums by about $1,900.

The seven rules of QCDs

TCJA UPDATE: The seven rules of QCDs have not changed, but there is a footnote to the “100%-to-charity” rule: See ¶ 7.6.06 below in the Professional Outline.

PART B: THE LIFETIME MINIMUM DISTRIBUTION RULES

TCJA UPDATE: TCJA made very minimal changes to PART B. There are no changes in the RMD rules themselves. Other TCJA changes indirectly affect the following statement(s) in the original Outline:
1.1 Introduction to the RMD Rules

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1.2.07 Adjustment for post-year-end recharacterizations

TCJA UPDATE: Recharacterization of Roth conversions is no longer permitted after 2017. See the author’s other 2018 Heckerling Outline, “Doth Thou Roth?” for details.

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1.9 Enforcement of the RMD Rules

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1.9.02 Failure to take an RMD: 50% excise tax, other effects

TCJA UPDATE: TCJA made no change in the following paragraph. I’m restating it here because the last sentence as it appeared in the original Outline was garbled. The ending of the paragraph has accordingly been revised; see italicized portion:

Note: Improper rollover or Roth conversion of the RMD: If an individual rolls over his RMD or converts it to a Roth IRA, he has not made a valid rollover or Roth conversion; see ¶ 2.6.03. He has a problem—but exactly what problem does he have? A common error in such situations is to frame the problem as “failure to take the RMD.” This characterization of the problem is erroneous. The situation involves two steps: A distribution from the first plan and a contribution to the second plan. There is no problem with the first step: As far as the IRS is concerned, the individual did take the RMD—so there is no 50% penalty involved. “[I]f an amount is distributed by one plan and is rolled over to another plan, the amount distributed is still treated as a distribution by the distributing plan for purposes of section 401(a)(9), notwithstanding the rollover.” Reg. § 1.401(a)(9)-7, A-2; emphasis added. The mistake that needs to be cleaned up is the second step—the invalid rollover or Roth conversion. The contribution will be an “excess contribution” if made to a traditional IRA (because the participant can’t contribute to a traditional IRA if over age 70½). It will be an excess contribution if made to a Roth IRA if the participant does not meet the applicable requirements for contributing to a Roth IRA (see the author’s other Heckerling 2018 Outline, “Doth Thou Roth?, “ for details on permitted Roth IRA contributions).

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PART C: QUALIFIED CHARITABLE DISTRIBUTIONS

TCJA UPDATE: The TCJA made no direct changes to the rules for qualified charitable distributions. The new limits on itemized deductions, and the newly increased standard deduction, increase the attractiveness of QCDs compared with other forms of charitable giving; see the “Morgan and Poppy Example” earlier in this Update.

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7.6.06 Requirements applicable to the gift itself

TCJA UPDATE: Though the TCJA did not change the rules applicable to QCDs, it did make one change that answers at least one question practitioners have had about a certain type of gift:

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C. Donor cannot get back anything of substantial value. More problematic is the effect of the § 408(d)(8)(C) limitation when the donor is to receive goods or services from the charity in exchange for his gift. The IRS has extensive and elaborate rules on this subject—for regular charitable gifts.
TCJA UPDATE: As always, the QCD rules require that 100% of the QCD-donation must be tax deductible under § 170 of the Code (without regard, for this purpose, to the percentage of income limits). As noted in the original Outline, this rule has created vexing problems for some gifts that are normally partially deductible under the Code because the donor gets something back—for example, the cost of attending a charity ball where the admission price is $10,000 and the donor “gets back” a dinner worth $60. With normal direct charitable gifts from the taxable account, the donor just reduces his charitable deduction by the value of the get-back. But under QCD rules, any get-back makes the total gift not a qualified charitable distribution. It would just be treated as a regular IRA distribution followed by an itemized-deduction type gift to charity.

One such situation involved donations to certain universities where a large donation entitled the donor to buy football tickets. The donation did not result in tickets—it just gave the donor the right to buy (at full price) certain tickets not available at all to the non-donating-general public. Prior to TCJA, a special rule in § 170 entitled these sports fans to deduct 80% of this type of donation. As a result of TCJA, § 170(l) now allows no deduction at all for such gifts—thus resolving one thorny issue for QCD practitioners: Football-ticket-buying-rights donations cannot be made in whole or in part as a QCD!

7.6.09 Using QCDs for the RMD; other planning uses and pitfalls

TCJA UPDATE: TCJA changes are indicated by strikeouts and boldface in the following paragraph:

C. Advantages of the QCD. The QCD eliminates some of the problems that arise when making lifetime charitable gifts from an IRA (see ¶ 7.7.01). A QCD does not increase AGI and therefore does not: increase the individual’s adjusted gross income for purposes of determining the extent to which his “net investment income” will be taxed (§ 1411); decrease the deductibility of medical expenses (§ 213(a)) or miscellaneous itemized deductions (§ 67(a)) [since miscellaneous itemized deductions are now completely non-deductible for individuals for the years 2018-2025, this advantage has disappeared]; increase the reduction of itemized deductions (§ 68(a)) [since there is no more “reduction of itemized deductions” (§ 68 repealed for the years 2018-2025), this advantage has disappeared]; increase the taxability of Social Security benefits (§ 86); increase Medicare premiums (42 U.S. Code §1395r(i)); or increase state income taxes (in a state that uses federal AGI as the basis for computing state income tax but does not allow a charitable deduction). Since there is no itemized charitable deduction for the QCD gift, the gift does not “count” for purposes of the percentage-of-income limits on charitable deductions in § 170(b); does not get reduced by § 68(a); § 68 repealed for the years 2018-2025, so this advantage has disappeared; and is in effect “deductible” even for someone who does not itemize deductions. See the “Morgan and Poppy Example” earlier in this Update for effect of new increased standard deduction.

7.7 Other Lifetime Gifts of Retirement Benefits

7.7.01 Lifetime gifts from distributions

A. Percent-of-income limit. The income tax deduction for charitable contributions is limited to a certain percentage (30% or 50%, depending on the type of property given and the type of recipient charity) of the individual’s gross income. § 170(b). If the individual’s donations exceed the deduction limit, the excess can be carried forward for a limited number of years. TCJA Update: The percentage limits were increased by TCJA; see other sources for details.

B. Deduction-reduction for high-income taxpayers. Charitable deductions are an itemized deduction, subject to the “reduction of itemized deductions” that applies to high-income individual taxpayers in years before 2009 and after 2012. § 68. The amount of the reduction is a percentage of the donor’s AGI—so the potential reduction is increased by the plan distribution, which increases AGI. A single individual starts to become subject to § 68 if he has more than $250,000 of AGI; for married taxpayers filing jointly, the level is $300,000. TCJA Update: § 68 has been temporarily repealed by TCJA for the years 2018-2025, so this disadvantage of lifetime gifts to charity made from the taxable account has disappeared.
C. PEP for high-income taxpayers. The personal exemption deduction is phased out under a different Code section (§ 151(d)) and schedule, again beginning at $250,000 of AGI for single taxpayers ($300,000 for married filing jointly). A retirement plan distribution, by increasing AGI, may cause loss of some or all of the taxpayer’s personal exemption. The charitable contribution does not offset this. TCJA Update: The “personal exemption phaseout” (PEP) has been eliminated by TCJA for the years 2018-2025, so this disadvantage of lifetime gifts to charity made from the taxable account has temporarily disappeared.

D. Deduction decreases taxable income but not AGI. Because the distribution is included in the individual’s gross income, it may increase his taxes in other indirect ways that are not offset by the charitable deduction, because the distribution increases his adjusted gross income (AGI) and the charitable deduction does not decrease AGI. For example, the plan distribution could decrease his medical expense deduction (limited to expenses in excess of 10% of AGI; see § 213) and miscellaneous itemized deductions (limited to expenses in excess of 2% of AGI; see § 67) [since miscellaneous itemized deductions are now completely non-deductible for individuals for the years 2018-2025, this disadvantage has disappeared]; increase his Medicare premiums (see Appendix B); decrease his eligibility to contribute to a Roth IRA (see the author’s other Heckerling 2018 Outline, “Doth Thou Roth?”); and/or increase the taxability of his Social Security benefits (see § 86).

H. Nonitemizers. An individual who uses the “standard deduction” rather than itemizing his deductions would see no income tax benefit from the charitable contribution. See the “Morgan and Poppy Example” earlier in this Update for effect of new increased standard deduction.

 Appendix C: Proposed Final TCJA Changes in the Tax Law

TCJA UPDATE: This Update shows which predictions made in Appendix C of the original Outline did or did not come true:

✔ The percentage-of-income limits on the itemized deduction for charitable gifts (§ 170(b)) would be modified. This did happen. See § 170 as revised by TCJA.

✔ “Recharacterization” of IRA contributions would no longer be permitted. This would eliminate the ability to “undo” (reverse) a Roth IRA conversion. This did not fully happen. TCJA did indeed eliminate the ability to “recharacterize” a Roth IRA conversion after 2017, but did not eliminate the ability to recharacterize other IRA contributions. For full details see the author’s other Heckerling 2018 Outline, “Doth Thou Roth?”

✔ § 68, which reduces the benefit of itemized income tax deductions for higher-income taxpayers, would be repealed. This did happen, effective for the years 2018–2025.

✔ The income tax deduction for medical expenses (§ 213) would be eliminated. This did NOT happen. Instead the deduction was made more generous, by allowing the deduction for medical expenses in excess of 7% of AGI (rather than the pre-TCJA 10%), effective for the years 2018–2025.

✔ The “standard deduction” (§ 63(c)) would be increased. This did happen, effective for the years 2018–2025.

As predicted, the Tax Cuts and Jobs Act did not make any changes to the “minimum distribution rules,” despite a number of legislative proposals in recent years to replace the life expectancy payout with a “5-year rule” for most retirement plan death benefits. Similarly, it would not impose required minimum distributions on Roth IRAs, another change that has been proposed in recent years.