MANAGING IRA RMDs WITH QCDs AND ROTH CONVERSIONS

By: Retirement Strategies Group

We've been talking a lot about Roth IRAs, again thanks to tax law changes, and particularly about expanded income-tax brackets and lower rates for most. In doing so, we started thinking: Could the two strategies find some common ground? Here's the idea we've have been kicking around: Gift required minimum distributions (RMDs) to charity, and convert an equivalent amount (or less) to a Roth IRA as a "tax neutral" play to manage traditional IRA payments that are neither wanted nor needed. Let's break it down.

QCDs

Qualified charitable distributions (QCDs) are charitable gifts of IRA distributions. If done properly, QCDs satisfy RMDs. They also aren't included as part of the IRA owner's adjusted gross income (AGI)—a number to determine both combined income for the income taxation of Social Security benefits and modified adjusted gross income for determining Medicare premiums for Parts B and D. As an example, a $25,000 QCD could count toward a given year's RMD but would not be added to that year's AGI. As a reminder, QCD donors must be age 70½ or older and be the named owner of an IRA (either the owner or the beneficiary of an inherited IRA). Something to note: The check must be paid to the charity but may be sent to the IRA owner. In that way, the owner can present the check to the charity and a copy of the check to his or her CPA during tax season as a reminder of the gift.

Roth Conversions

Traditional IRAs and other qualified retirement savings may be rolled over (or converted) to a Roth IRA. Two unique features of Roth IRAs are (1) their owners are not required to take payments during their lifetimes and (2) their profits may be distributed tax-free as qualified distributions. The catch is that their contributions, including conversion contributions, are after-tax, meaning that the conversion of pretax IRA or other retirement savings is a taxable event. A second catch is that conversions are now irrevocable, as recharacterizations of conversions were eliminated as part of the recent tax law changes. If willing to pay the tax, traditional IRA owners can convert these savings to a Roth IRA to get out from under RMDs. Partial conversions may be implemented to manage bracket creep (convert just enough to avoid bumping up to the next income-tax bracket) or government benefits' threshold crossings (convert without paying more income tax on Social Security benefits or higher premiums for Medicare Parts B and D).

Putting It All Together

Charitably inclined individuals may off-load RMDs from their income-tax returns through QCDs. They also may wish to consider rolling over some funds (in an amount equal to the off-loaded RMD?) to a Roth IRA in the same year as the QCD. While the rollover will generate a tax bill, the bill itself could be planned so that it is no bigger than the bill the RMD would have produced had it not been gifted to charity. Continuing with the earlier example of the $25,000 QCD, the IRA owner might consider converting $25,000 to a Roth IRA in the same year as the gift. This "tax neutral" play may be attractive for several reasons: lower income-tax rates on converted amounts until 2026; the whittling away of the traditional IRA account value that will serve to determine the size of future RMDs; and the creation of a Roth IRA that can be used as either a live-on or leave-on asset that may be more tax efficient down the road if and when income-tax rates are higher.

For additional information about QCDs, RMDs, and Roth IRA conversions, please feel free to contact the Retirement Strategies Group at (800) 722-2333 or email RSG@PacificLife.com.
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