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Are You Prepared For RMDs?

(Required Minimum Distributions)

What Is A Required Minimum Distribution (RMD)?

A Required Minimum Distribution (RMD) is a yearly minimum withdrawal that must be taken from certain types of retirement accounts once you reach a specific age. This concept was introduced to ensure that savings in these tax-advantaged accounts do not grow indefinitely but are rather distributed over the account owner's lifetime. RMDs must be taken by December 31st each year, but the first distribution can be delayed until April 1st of the year following the year in which you turn 73 or leave your company, whichever is later. Keep in mind that this technically means you would be required to take two RMDs that following year.[1]

RMDs apply to most retirement plans, including traditional IRAs, SEP IRAs, SIMPLE IRAs, rollover IRAs, most 401(k) and 403(b) plans, and most small business accounts. However, RMD rules do not apply to Roth IRAs while the owner is alive, but they do apply to inherited IRAs.

Calculating your RMD involves dividing the year-end value of your retirement account by a distribution period or life expectancy factor. This factor is usually determined by the IRS, and different situations may call for different calculation tables. For instance, couples with a significant age difference should use the IRS Joint Life and Last Survivor Expectancy Table.

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Are You Prepared For RMDs?

Age Of Retiree	Distribution Period (In Years)
72	27.4
73	26.5
74	25.5
75	24.6
76	23.7
77	22.9
78	22.0
79	21.1
80	20.2
81	19.4
82	18.5
83	17.7
84	16.8
85	16.0
86	15.2
87	14.4
88	13.7
89	12.9
90	12.2
91	11.5
92	10.8
93	10.1
94	9.5
95	8.9
96	8.4

Age Of Retiree	Distribution Period (In Years)
97	7.8
98	7.3
99	6.8
100	6.4
101	6.0
102	5.6
103	5.2
104	4.9
105	4.6
106	4.3
107	4.1
108	3.9
109	3.7
110	3.5
111	3.4
112	3.3
113	3.1
114	3.0
115	2.9
116	2.8
117	2.7
118	2.5
119	2.3
120 and older	2.0

For inherited IRAs, RMD rules are based on the relationship to the original owner.[2]

Source: Internal Revenue Service (IRS) via https://www.bankrate.com/retirement/ira-rmd-table/

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The SECURE Act 2.0 And The Change To RMD Ages

The SECURE (Setting Every Community Up for Retirement Enhancement) Act 2.0, which passed in the final days of 2022, is the most significant retirement-related law seen since the initial passage of the SECURE Act in 2019.

One noteworthy transformation that will influence all retirees with common retirement accounts is that the age of Required Minimum Distributions has been raised from 72 to 73, with a provision that then raises the age to 75 after 2032. Even though it implies retirees can have more time for their savings to accumulate without taxation, they should not underestimate the eventual impact of RMDs on their tax liability and retirement savings. Note that those who turned 72 prior to December 31st of 2022 are still subject to the previous RMD rules requiring distributions at the age of 72.

Starting at age 73, the pre-tax money you put away over the course of your career will now be subject to tax, and the government has a specific method of calculating how much you must withdraw every year based on your account balance and life expectancy.[3]

If you have multiple retirement accounts, you may consolidate your RMD requirement from identical account types and execute a single withdrawal from one of the accounts. However, it's not permissible to take an RMD required for an IRA from a 401(k) or the other way around. Also, such consolidations are not applicable when it comes to employer-sponsored accounts.

So, while you're allowed to meet your RMD requirement from multiple IRAs via one withdrawal, you are not allowed to take the RMDs that are mandatory for one type of retirement account from another type of account.[4]

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RMD Penalty Decreased

The penalty for failing to take an RMD used to be 50%. But as of the SECURE Act 2.0, it has decreased to 25% of the RMD amount and 10% if corrected in a timely manner for IRAs.

Exceptions To The Penalty

There are exceptions to these rules: You don't have to take RMDs from your current 401(k) if you're still working past the age of 73 and own less than 5% of the company you work for.[5]

RMDs are not required from a Roth IRA or Roth 401(k) account as of the SECURE Act 2.0.[1] If you've invested in a Roth 401(k) or Roth IRA, the money can continue to grow in the account tax-free for the rest of your life.

Lowering RMDs

Tax minimizations are an important part of retirement planning. RMDs can really throw this off, especially for people who have saved considerable amounts in their retirement accounts. We know what the tax rates are now, but what about 10 years from now? The current Tax Cuts and Jobs Act expires at the end of 2025 but could expire sooner, depending on legislative decisions. Not only are RMDs taxed, but they are also considered part of your adjusted gross income and could push you into a higher tax bracket, causing higher taxes on your Social Security benefits, a Medicare high-income surcharge, and a surtax on your taxable investments.[6]

So, what can you do? Rather than sit back and wait around for the government to tax you as much as possible, you can strategize ahead of time to minimize your tax burden.

Withdrawing Before 73

You can start withdrawing from your retirement accounts without incurring a penalty at age 59 ½, and in some cases 55, to lower your account balance and thus your RMDs.[7] As part of an income strategy, you can reinvest the withdrawals or use them as your primary source of income. This could be beneficial if you wanted to delay taking Social Security in order to maximize your benefit amounts.

Convert To A Roth

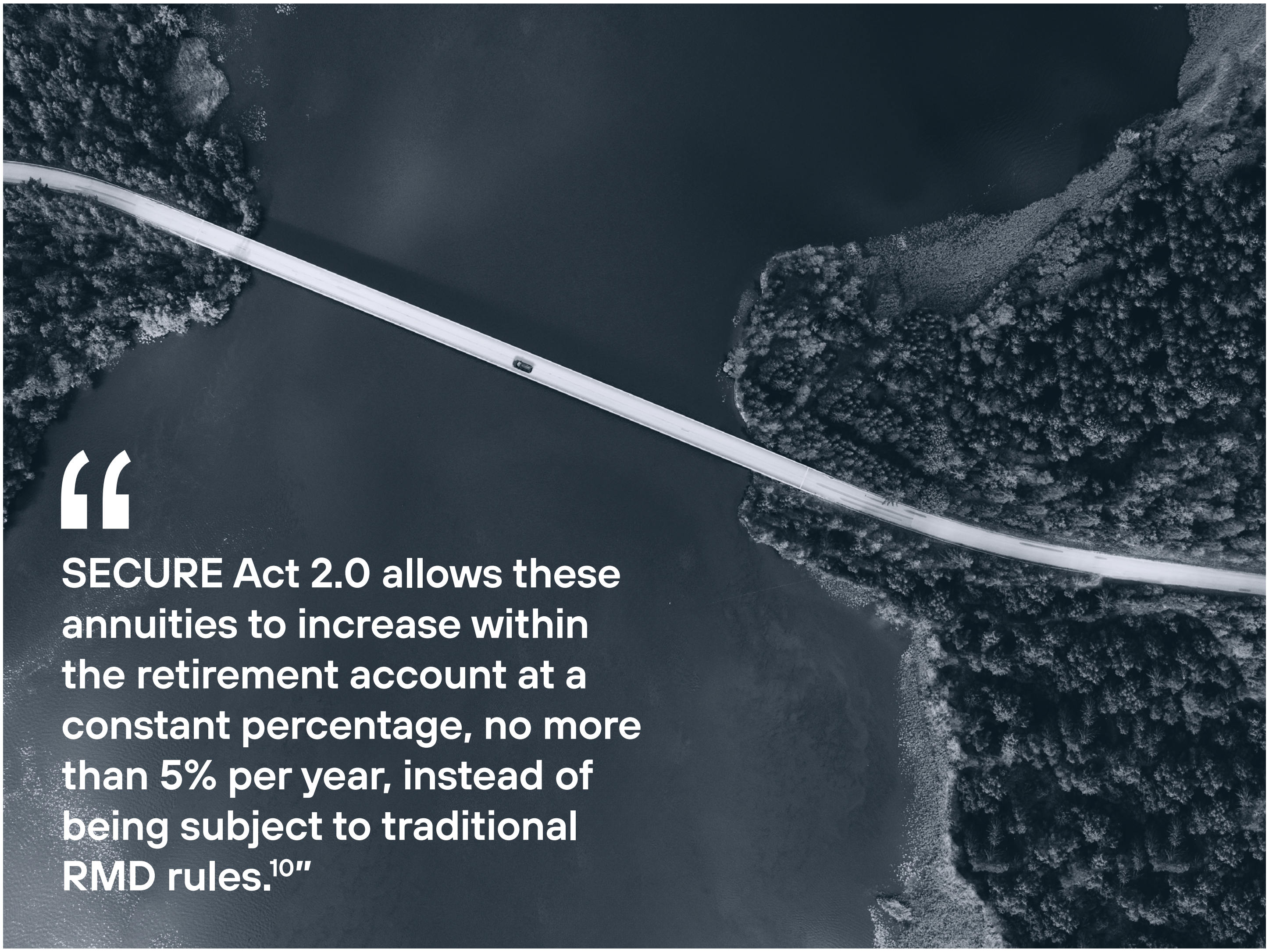
Another option is to convert funds to a Roth IRA. This means you'll pay tax on the amount you convert all at once instead of later when you withdraw it. You don't have to withdraw from a Roth IRA at any age, so the funds can continue to grow tax-free for the rest of your life.[6]

Starting in 2024, designated Roth 401(k) account holders will no longer be required to take RMDs. This rule already exists for Roth IRA holders, too.[1]

Contribute To A QLAC

A qualified longevity annuity contract (QLAC) is a deferred income annuity that starts paying out after a determined period of time. When the QLAC income phase starts, distributions are taxed at regular income rates. You can invest up to $200,000 from your 401(k) or IRA in a QLAC and reduce the amount in your retirement accounts. The reason these can be beneficial for your RMD situation is that QLACs allow you to reduce your RMDs for several years. They are funded with a premium payment to an insurer, and the amount that is invested in the QLAC won't be considered part of your IRA for RMD calculation.[8]

NOTE: For in-plan annuity payments that exceed the participant's RMD amount, the excess annuity payment can be applied to the year's RMD.



RMDs, Annuities, And The SECURE Act 2.0

The SECURE Act 2.0 also removed a few barriers for lifetime annuities to be held in qualified plans like IRAs.[9] The barriers had previously been a result of the strict RMD rules.

Specifically, SECURE Act 2.0 removes accessibility barriers to some lifetime annuities in defined-contribution retirement accounts. Previously, RMDs limited the availability of some lifetime annuities, which had large benefit increases from year to year. This benefit structure would clash with the RMD rule that aims to slowly bring your account value close to 0 at the very end of your life expectancy. SECURE Act 2.0 allows these annuities to increase within the retirement account at a constant percentage, no more than 5% per year, instead of being subject to traditional RMD rules.[10]

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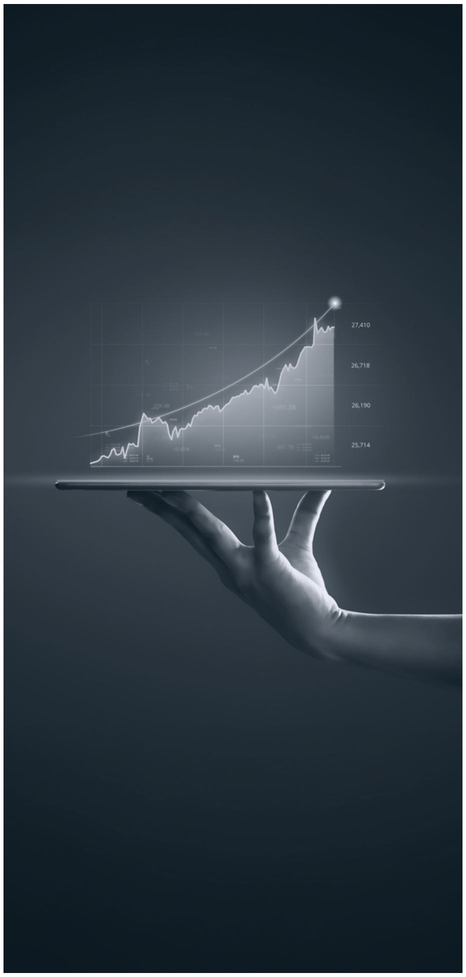
What Can You Do With An RMD?

Make A Qualified Charitable Distribution

Making a qualified charitable distribution can be a good way to make use of your RMDs and lower your tax burden. A Qualified Charitable Distribution (QCD) is not considered taxable income, as it goes directly to a charity. Even though the SECURE Act 2.0 increased the age for RMDs from 72 to 73, it did not increase the eligible age for qualified charitable distributions. So, IRA owners 70 ½ or older can still make a QCD.[11]

Starting in 2023, individuals aged 70 ½ and above will be allowed to donate up to $50,000 (adjusted yearly for inflation) to charitable remainder unitrusts, charitable remainder annuity trusts, or charitable gift annuities as part of their QCD limit. This ultimately increases the number of charities that can be given QCDs. In addition, your donation will be part of the RMD for the year, when applicable. Note that for the gifts to be counted, they must be sent directly from the IRA by the end of the calendar year. It is important to remember that QCDs cannot be given to all charities.[12]



Reinvestment

You can't roll over an RMD into another tax-advantaged account because then the IRS would not receive tax money from the withdrawal. However, you can immediately reinvest an RMD into a taxable account, ETFs, stocks, or bonds after taxes have been paid on it.

Inherited IRAs

The rules regarding RMDs become more complicated when they pass from the original owner to a beneficiary. If the original owner does not take an RMD in the year prior to his or her death, the beneficiary must take the RMD before the end of the calendar year.[13] This can be confusing for the beneficiary if they don't know how RMDs work ahead of time and are grieving the loss of a loved one.

Changes In Estate Planning

The original Secure Act eliminated the option for non-spouse beneficiaries to take RMDs based on their own life expectancy. This "stretch" IRA option allowed IRA beneficiaries to take RMDs over the course of their life instead of the original owner's, effectively stretching the life of the IRA and resulting in smaller RMDs. Now, IRA beneficiaries must deplete accounts within 10 years.[2] This means potentially missing out on years of tax-free growth and an increased tax burden for those who are forced to withdraw more than they want to. This is a major upheaval in estate planning, and those who plan to pass on or inherit an IRA should review their estate plan.

Fortunately, if the beneficiary is the spouse of the original owner, then he or she can delay RMDs until the year the original owner would have turned 73, and then still use his or her own life expectancy to determine RMDs. Alternatively, the surviving spouse can roll over the inherited IRA into his or her own IRA. In this case, the basic rules of IRA ownership apply.

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Avoiding Penalties

As mentioned above, the IRS will take a 25% penalty on the amount you were supposed to withdraw in addition to the taxes owed on the full amount of the RMD.[5] So it's understandable that the complex rules surrounding RMDs can make people nearing 73 nervous. It's also easy to forget to take two RMDs in one year if you delay your first RMD, and if you have multiple 401(k)s in addition to an IRA, it can be hard to keep everything straight. Add in all the changes from the SECURE Act 2.0, and RMDs can seem quite complex.

The good news is that if you miss an RMD for a legitimate reason, you can ask the IRS to waive the penalty and take the RMD as soon as possible. This process can be cumbersome, so it's better to avoid the issue altogether by making sure to take RMDs.

> **"There are certain rules and limitations that come with penalty payments and strategies to consider that help avoid those costly penalties in a way that makes sense for your unique financial goals and situation."**

RMDs And You

It's easy to get lost in the details of how RMDs work, let alone how they apply to your own situation. There are certain rules and limitations that come with penalty payments and strategies to consider that help avoid those costly penalties in a way that makes sense for your unique financial goals and situation. If learning and staying up to date on all these rules and strategies isn't what you want your retirement to center on, reach out to the financial professionals at VestGen Wealth Partners. We'll sit down with you to understand your unique financial situation and goals and help construct, execute, and upkeep a plan for RMDs that can work for you.

GetRetiredStayRetired.com

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