Making Sense of Required Minimum Distributions

In the world of retirement planning, few topics generate as much confusion as Required Minimum Distributions (RMDs). For retirees and investors alike, understanding RMDs is critical for optimizing your financial strategy in retirement and avoiding costly mistakes. This guide will clarify recent changes to RMD regulations, how distributions are calculated, the penalties for non-compliance, tax considerations, and how to withdraw RMDs.

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WHAT ARE RMDs?

RMDs are the minimum amounts that retirement account holders must withdraw annually once they reach a certain age. This rule applies to tax-deferred accounts like traditional IRAs, 401(k)s, 403(b)s, and similar retirement savings vehicles. The rationale is straightforward: since these accounts have grown tax-free over the years, the IRS mandates that taxes eventually be paid on these funds through required distributions.

WHEN RMDs BEGIN FOR DIFFERENT ACCOUNTS

Generally speaking, RMDs are required when you reach the age of 72. However, beginning in 2023, the Secure 2.0 Act changed the age to begin RMDs from 72 to 73 for those who reach 72 after December 31, 2022. So, if you turn 73 in 2024, you will need to start taking RMDs. Generally, your first RMD is due by April 1 of the year after you turn 73, with all subsequent RMDs due by December 31 each year. While deferring your first RMD until the following year is possible, doing so means you'll take two RMDs in one tax year, which could lead to a larger tax bill if the additional income bumps you into a higher tax bracket. For instance, if you turn 73 in 2024, delaying your first RMD until April 1, 2025, would require you to take another by December 31, 2025.

For Traditional IRAs (including SEP and SIMPLE IRAs), the first RMD must be taken by April 1 of the year after you turn 73, a change introduced by the Secure 2.0 Act. Employer-sponsored retirement plans like 401(k)s and 403(b)s follow the same rule for the first RMD but allow for deferral until retirement if you own less than 5% of the business. If you own a Roth IRA, there's good news: these accounts are not subject to RMDs during the original owner's lifetime, allowing for continued tax-free growth. Starting in 2024, RMDs are no longer required from designated Roth 401k and Roth 403b accounts like in the past.

HOW RMDs ARE CALCULATED: THE BASICS

Calculating your RMD is straightforward. The IRS requires you to use each tax-deferred retirement account balance as of December 31 of the previous year and divide it by a life expectancy factor

based on your age. These factors, outlined in IRS tables, are designed to stretch distributions over your lifetime, ensuring a manageable withdrawal amount each year.

For example, if you turn 74 in 2024 with a traditional IRA balance of $500,000 as of December 31, 2023, your RMD would be approximately $19,607, based on an IRS distribution period of 25.5. This amount is taxable as ordinary income, making tax planning essential. Please note that these distribution period calculations can depend on several factors, such as whether you are single or married, have a spouse 10 years younger than you, or have multiple designated beneficiaries.

Distribution Period Calculations

Age	Distribution Period	Example Balance ($500,000)	Calculated RMD
73	26.5	$500,000	$18,867
74	25.5	$500,000	$19,607
75	24.6	$500,000	$20,325

AVOIDING PENALTIES

Missing an RMD deadline can be costly. The IRS imposes a steep 25% penalty on any missed RMD amount. However, if you catch and correct the mistake, you might qualify for a reduced penalty of 10%. Keeping track of each RMD, particularly if you have multiple accounts, is essential for staying compliant with the IRS.

AGGREGATING RMDs FOR SIMPLICITY

If you have multiple IRAs, you can aggregate the total RMD amount and withdraw it from a single IRA. However, 401(k)s and similar employer plans require separate RMD calculations for each account, so you'll need to withdraw from each one individually. There is an exception for 403(b) accounts that allows totaling RMDs for those accounts and then taking one or more RMDs from any of those 403(b) accounts.

STRATEGIES TO MANAGE RMDS AND TAXES

Taking RMDs doesn't have to mean a significant tax hit each year. Here are a few strategies our advisors often discuss with clients:

1. Consider Roth Conversions Before Age 73: Moving part of your traditional IRA into a Roth IRA can be a smart strategy, as Roth IRAs are not subject to RMDs. You'll pay taxes on the amount you convert, which could reduce future RMDs and provide tax-free growth in your Roth account.

2. Qualified Charitable Distributions (QCDs): Once you turn 70½, you can direct up to $105,000 (2024 limit) or $108,000 (2025 limit) (indexed for inflation) annually from an IRA to a qualified charity as a QCD. This amount counts toward your RMD but is not included in your taxable income.

3. Qualified Longevity Annuity Contracts (QLACs): For those interested in deferring income further, a QLAC allows you to delay RMDs on a portion of your IRA or 401(k) assets until age 85, helping to lower RMDs in earlier years.

A PERSONALIZED APPROACH TO YOUR FINANCIAL PLAN

While the intricacies of RMDs can feel overwhelming, our financial advisors at Cary Street Partners are here to help you navigate the process smoothly and confidently. Although we don't provide specific tax advice, we can work closely with you to develop a financial plan aligned with your goals and help coordinate with your tax advisor when needed. From clarifying RMD requirements to exploring tax-minimizing strategies, we're committed to helping you maximize your retirement assets.

By understanding your RMDs and proactively managing them, you're taking an essential step toward financial security in retirement. For more guidance on this and other topics, stay tuned to our Wealth Wisdom series, where we share insights to support your journey to lasting financial well-being.

Source: IRS.gov; "Retirement Topics – Required Minimum Distributions (RMDs)," "Publication 590-B (2023) Distributions from Individual Retirement Arrangements (IRAs)," "Retirement Topics – Net Unrealized Appreciation (NUA)," "Qualified Charitable Distributions," "Instructions for Form 5329"

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