ARE YOU PREPARED FOR RMDs

REQUIRED MINIMUM DISTRIBUTIONS

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WEALTH & TAX SOLUTIONS

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

One noteworthy transformation which will influence all retirees with a standard retirement account like an IRA or 401(k) 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[1]. 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.

Once you turn 73 you must start taking required minimum distributions (RMDs) from your tax-deferred retirement accounts. These include traditional IRAs, rollover and inherited IRAs, SIMPLE IRAs, SEP IRAs, 401(k)s, 403(b)s and 457(b)s. Until recently, RMDs were required starting at age 72, but the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0 changed the age to 73. 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.

If you turned 72 in 2022 or earlier, you will need to continue taking RMDs as scheduled. If you're turning 72 in 2023 and have already scheduled your withdrawal, you may want to consider updating your withdrawal plan.[2]

Age	Distribution Period	Age	Distribution Period
73	26.5	87	14.4
74	25.5	88	13.7
75	24.6	89	12.9
76	23.7	90	12.2
77	22.9	91	11.5
78	22.0	92	10.8
79	21.1	93	10.1
80	20.2	94	9.5
81	19.4	95	8.9
82	18.5	96	8.4
83	17.7	97	7.8
84	16.8	98	7.3
85	16.0	99	6.8
86	15.2	100	6.4

[3]

If you have more than one retirement account, the RMD will be based on the total of funds in all accounts, and you can pay the full amount out of just one IRA or multiple IRAs.[4] However, this rule does not apply to employer sponsored retirement plans or inherited IRAs. For these you must calculate and withdraw RMDs from each account.

Your first RMD is due by April 1st of the year after you turn 73.[5] So, if you turn 73 in 2023, you won't need to take your first RMD until April 1st, 2024. Keep in mind that by pushing back the first RMD, you could end up having to take two RMDs in one year, since all RMDs after the first are due by December 31st. This could mean you'll have to withdraw more than you want, potentially resulting in a higher tax burden. When it comes to RMDs, planning is key.

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 decrease to 25% of the RMD amount, and 10% if corrected in a timely manner for IRAs.[6]

Exceptions to the Rule

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 percent of the company you work for.[7] Also, RMDs are not required from a Roth IRA or Roth 401(k) account as of the SECURE Act 2.0. If you've invested in a Roth, the money can continue to grow in the account tax free for the rest of your life.[8]

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.[9]

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

For instance, 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. You can re-invest the withdrawals or use them as your primary source of income so that you can delay taking Social Security to maximize that benefit.

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.[10]

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. You can invest up to $200,000 in your 401(k) or IRA in a QLAC and reduce the amount in your retirement accounts.[11] 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, at which time the amount that is invested in the QLAC won't be considered part of your IRA for RMD calculation.

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 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. The barriers had previously been a result of the strict RMD rules.[12]

The changes would allow someone to choose a lifetime income annuity with a return of premium at death benefit and still meet the RMD rules. Ultimately, this makes lifetime income annuity decisions inside of defined contribution plans and IRAs more appealing because a broader range of products will not meet the RMD rule.[13]

No RMD Increases for Partial Annuitization

SECURE Act 2.0 allows for participants to elect aggregate distributions from both the annuity and other investments sections of their retirement accounts in order to determine if the distributions meet the RMD rules. Before, annuitiy distributions and regular RMDs needed separate calculations.[14]

The new rules would allow someone to treat their entire distribution amount all as one distribution.[15]

Annuities In Retirement Accounts are Still Complex

RMD rules in real life applications are complex and often need a second look. While the SECURE 2.0 Act makes some reasonable changes to RMD rules, it doesn't remove the complexity around them.[16]

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

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 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.

Starting 2023, individuals aged 70½ 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 is an increase in the number of charities that can be given QCDs. This amount 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.[17]

Reinvestment

You can't rollover 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.[18] 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.[19] 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. Or, 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.

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.[18] So it's understandable that the complex rules surrounding RMDs can make people nearing 73 nervous. It's easy to forget to take two RMDs in one year if you delay your first RMD. Or, 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 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.

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www.hilltopwealthsolutions.com

Mishawaka Office: 527 Park Place Court, Suite 100 Mishawaka, IN 46545
Bremen Office: 105 W. Plymouth St,.Bremen, IN 46506
Chesterton Office: 830 East Sidewalk Road, Chesterton, Indiana 46304
Indiana Private Meeting Rooms: 102 E. Main Street, Peru, IN 46970
Fort Myers Office: 13420 Parker Commons Blvd., Suite 106, Fort Myers, FL 339124
Royal Oak: 333 W. 7th Street, Suite 250, Royal Oak, MI 48067

Wealth Solutions (574) 889-7526
Tax Solutions (574) 208-5001

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