3 RMD STRATEGIES TO REDUCE TAXES

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What's Discussed

- Required Minimum Distributions (RMDs) are mandatory withdrawals from retirement accounts, like traditional Individual Retirement Accounts (IRAs) and company sponsored 401Ks
- For some retirees, Social Security benefits and other income may cover expected living expenses. Even if you may not need RMD funds for retirement spending, you're still required to take them out of your retirement account. RMDs are taxed at your ordinary income tax rates. Planning and making tax efficient withdrawals could potentially save you money.
- To reduce future taxes on RMDs, consider these strategies:
  - Use RMDs for year-end estimated tax payments
  - Donate RMDs to charity
  - Convert traditional IRA funds to a Roth IRA to reduce the size of future RMDs
- The best strategies for you will depend on your individual financial situation. Each strategy has specific rules and guidelines to follow. Atlas Capital is happy to consult with you and your tax planner.

1. Use RMDs for Year-End Estimated Tax Payments

A useful but little-known opportunity is to use RMDs to manage the timing of estimated tax payments. Most taxpayers make roughly equal estimated tax payments across the four payment dates. But estimated taxes paid from RMDs can be paid at year-end, offering a time value of money benefit.

Withholding taxes paid directly from retirement plans are considered to have been paid evenly throughout the taxable year even if actually paid in a lump sum at the end of the year. Therefore, a taxpayer who must make a Required Minimum Distribution can defer some of their estimated tax payments to year-end. More investment income can be earned during the year if estimated taxes are paid out of RMDs at the end of the year, rather than quarterly.

If the estimated tax due is smaller than the RMD, then the taxpayer can divide the RMD payment between the tax part (going to the IRS) and the remainder (to themselves). For instance, the taxpayer might take most of the RMD at the beginning of the year, and the withholding tax part at the end.

2. Donate RMDs to Charity

Another strategy is to use RMDs from your IRAs for charitable giving. The portion of an RMD sent directly to charity, called a Qualified Charitable Distribution (QCD), is not taxed. If the RMD were sent to an individual's own account, it would be taxed as ordinary income. Therefore, it is possible to reduce taxes and increase the amount available for charitable purposes by using a QCD.

A reduction in taxable income through use of a QCD can be particularly important for individuals who might otherwise end up in a higher tax bracket, owe the Medicare surtax, or have Social Security benefits become taxable. In most cases, the tax savings from using QCDs for charitable giving exceeds the benefit of making the same donations from a taxable account, because of the limitations on itemized deductions.

3. Convert to a Roth IRA to Reduce Future RMDs

Another way to reduce taxes on RMDs is to reduce the size of RMDs. You can do this with a Roth conversion, where you convert holdings in your tax deferred accounts to a Roth account, which is exempt from RMDs. While this incurs immediate taxation on the converted amount, Roth IRAs grow tax-free, and qualified distributions are tax-exempt if you are over age 59½. A conversion makes especially good sense if you believe you'll be in a higher bracket when you eventually withdraw the money.

A Roth IRA can also provide flexibility in managing taxes during retirement. Having a mix of taxable, tax-deferred, and tax-free accounts allows you to draw income from various account types to optimize tax efficiency.

To note, some of the larger Roth conversion considerations:

- It's to your advantage to pay any conversion income-tax liability from other taxable account assets so that you maximize the amount going into the Roth
- Convert after age 59½ to avoid early withdrawal penalties
- When you convert, your taxable income for the year rises, which could bump you into a higher tax bracket
- You must wait five years to make tax-free withdrawals after a conversion

Summary

Much of the retirement advice assumes a lower tax bracket in the retirement years. If that is not your situation, RMD strategies may help manage the tax burden. Because RMD strategies entail many complex considerations like IRS rules and your individual financial situation, it is important to know the rules and guidelines for each strategy. As professional financial advisors, we enjoy helping you with questions like this.

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