Rochester Wealth Strategies

439 S Main St, Suite 250
Rochester, MI 48307
(248) 434-6550

Understanding RMDs

By Julie Lobaza

When planning for retirement, several factors must be considered. Required Minimum Distributions (RMDs) are a crucial but often misunderstood component. RMDs are the minimum amounts that you must withdraw from your retirement account each year once you reach a specific age determined by the government. They are essentially the government's way of ensuring that individuals with tax-advantaged retirement accounts, such as 401(k)s and Traditional IRAs, eventually pay taxes on the money they have saved for retirement and do not accumulate indefinitely without any collection of taxes. Let's look at some of the details of RMDs, explaining what they are, when they come into play, and the key factors to consider.

Effective January 1, 2023, the RMD age increased from 72 to 73. For those born in 1960 or later, RMDs will need to begin at age 75. RMD amounts are calculated by a formula that considers your age, life expectancy and balance of your retirement accounts. The formula divides the account balance on December 31 of the prior year by a life expectancy factor determined by the IRS tables. For example, if you turned 75 this year and your IRA had a balance of $500,000 as of December 31 of the previous year. You would look up the IRS life expectancy factor for someone aged 75, which might be around 24.6. Your RMD would then be calculated as $500,000 ÷ 24.6, which equals approximately $20,325.20. This means you must withdraw at least $20,325.20 from your IRA this year to satisfy your RMD requirement. It's important to note that there are penalties for failing to take your RMD by December 31st of each year.

Tax implications are one key consideration that you should be aware of. RMDs withdrawn from your account are generally taxable as ordinary income. Review and adjust your withdrawal plan to allow for the RMDs and minimize tax liabilities.

There are some opportunities that may be available to help reduce taxes and maximize efficiency. You may want to take advantage of Qualified Charitable Distributions (QCDs) to satisfy some or all of your RMD to reduce your taxable income by giving to a charity directly from your retirement account, even if you claim a standard deduction. Additional considerations should be made if you have multiple accounts. Because you can satisfy your total RMD from any account, determine the underlying holdings and any features of the accounts themselves that may be impacted. If you want more flexibility in future retirement income planning, then you might want to consider doing some Roth conversions since they don't require RMDs in the account owner's lifetime.

Different rules apply if you inherit a retirement account, depending on your relationship to the account owner and type of account. It is critical to understand the specific rules for inherited accounts and how they influence your overall plan.

Understanding RMDs is an essential part of the retirement planning process. Consulting with a financial advisor can provide valuable guidance in managing RMDs and optimizing your retirement income strategy. Ultimately, proper planning and compliance with IRS regulations will help you maximize your retirement savings while minimizing tax liabilities.