**Required Minimum Distribution (RMD) Tax Reduction**

Individual Retirement Accounts (IRA) came into being with the passage of the Employee Retirement Income Security Act (ERISA) in 1974. While they have evolved over the years, the basic idea hasn't changed. Traditional (non-Roth) IRAs allow individuals to save (with certain limits) a sum of money every year from their pretax income and invest it in an account, typically at a bank or broker. There is an immediate tax saving from the reduction of your taxable income. The amounts deposited in the IRA can be invested in a variety of asset categories and benefit from tax-free compounding - a powerful wealth-building tool.

However, at some point, funds will be withdrawn from the account. Withdrawals enter the individual's taxable earnings stream and are taxed at the ordinary income tax rate in place at the time of the withdrawal. Withdrawals prior to age 59 1/2 incur a 10% early withdrawal penalty (subject to certain waivers) in addition to any tax owed. After 59 1/2, funds can be withdrawn in any amount at any time without penalty. Again, the withdrawals will be taxed at the ordinary income tax rate at the time of the withdrawal.

Beginning at age 72, you are required to withdraw annually, a minimum amount from your IRA (required minimum distribution or RMD) which, like any withdrawal, enters your taxable income stream at ordinary tax rates. At age 72, the RMD is about 4% of the total value of your retirement accounts. You can always withdraw amounts greater than the RMD.

The IRA custodian should calculate the correct RMD amount for you and withdraw the funds on a timely basis. Failure to withdraw the entire annual RMD results in *hefty penalties,* so I'd recommend you double-check with the IRA custodian, your tax advisor, and/or financial advisor that the calculations and withdrawals are correct before the end of the year.

For most people, the RMD is an important part of their retirement income and its taxable nature is not really an issue. However, people over 72 with other sources of income may find themselves paying taxes on income they don't need to support themselves. Hence the question: what can be done to reduce the RMD?

The following is a list of some of the options available to reduce the RMD. Once again, I strongly recommend you consult with your accountant and/or financial advisor regarding these strategies. Any steps taken must be done correctly and on a timely basis. Messing up could cost a lot of money. *Be careful!*

**Convert your traditional IRA to a Roth IRA.** The key advantage of converting is all withdrawals are tax-free and there is no RMD. However, there are several issues to consider. 1. In my view, the biggest issue is having to pay taxes at the ordinary rate on the amounts converted to a Roth IRA. 2. The taxes paid are assets forever lost to the government, thus no longer compounding tax-free on your behalf. 3. If you expect your tax rate to fall in the future, converting to a Roth IRA may be "sub-optimal". 4. Depending upon your age, the breakeven period for paying taxes now to save in the future may exceed your life expectancy making a Roth conversion not worthwhile. Please check with your financial advisor before moving ahead with a Roth conversion!

**Consider a Qualified Charitable Deduction (QCD).** Here's the IRS definition:

***Generally, a Qualified Charitable Distribution, or QCD, is an otherwise taxable distribution from an IRA (other than an ongoing SEP or SIMPLE IRA) owned by an individual who is age 70½ or over that is paid directly from the IRA to a qualified charity. Your Qualified Charitable Distributions can satisfy all or part the amount of your Required Minimum Distribution from your IRA.***

So, instead of having your RMD sent to your bank account and becoming taxable income, you can have your RMD sent directly to a charity (up to certain limits, of course). By doing this, the RMD does not enter your income stream and any tax is avoided. Additionally, by not entering your income stream, it does not affect IRMAA (those of us who pay Medicare premiums know what this is) potentially saving even more money by preventing an increase in your Medicare premium.

You can begin using QCD's when you turn 70 1/2 and it may make sense to begin the charitable gifting process then as these tax-free withdrawals reduce the value of the IRA account reducing future RMDs. Importantly, take the time to understand the rules and speak to your IRA custodian and the charities to make sure the money passes directly from your IRA to the charity. And check with your tax advisor as well!

**Make a Qualified HSA Funding Distribution (QHFD).** This strategy only works if you have an HSA (health savings account). If you don't know what an HSA is or you are over 65, forget about it. If you do have an account and are eligible, you may contribute to your HSA directly from your IRA. This will reduce the value of your IRA and thus the future RMD. This is a *one-time* transfer limited to the maximum amount allowed by IRS rule but also reduced by any employer contributions to your HSA. And, not surprisingly, you can't deduct this HSA contribution from your taxes. I think a check with your tax advisor is warranted if you want to use this strategy!

**Consider a Qualified Longevity Annuity Contract (QLAC).** A QLAC is an annuity that can be purchased in your IRA but is not subject to RMD and you can defer taking annuity payments until you are 85. There are a variety of rules and limits to the amount you can put in the annuity of the lesser of 25% of the IRA's value or $135,000. Recognize that as annuities, the remaining value of the QLAC goes to the provider upon your death, not to your heirs. You should also assume that you will not be able to recover the annuity principal should you need the funds while you are still alive. The benefit of the QLAC purchase is the reduction of your IRA account's value which lowers the RMD as well as guarantees a lifetime income.

**Don't stop working.** If you are currently contributing to a 401(k) and don't own 5% or more of the company, you can keep working past age 72 to delay any distributions thus avoiding the taxes. When you finally retire, distributions and the taxes on them will start. Importantly, 401(k) plans from old employers and any IRAs will still be subject to RMD when you hit 72. Should you keel over at your desk, think of all the taxes you will have saved!

**Take early withdrawals.** Once you turn 59 1/5 and until you are 72, any amounts you take from your IRA, while taxable, will reduce your IRA balances and future RMD's. For example, you could defer your Social Security until you hit 70 by using your IRA to tide you over.

**Reduce other income.** Perhaps you can reduce some other sources of taxable income. For example, by reducing the yield from your taxable brokerage account by investing in companies that don't pay dividends or tax-free municipal bonds.

**Relax.** Tax law, rates, rules, and regulations are always changing. RMD reduction strategies that make sense today, may not work tomorrow. Perhaps we are better off leaving things the way they are.

In summary, retirement account regulations are outrageously complex and errors can be very costly. So, whatever you choose to do, please consult with your financial advisors before taking any action. The rules and RMD mitigation strategies are likely to change over time as Congress and the Executive branch fiddle with the tax code.

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