

# REQUIRED MINIMUM DISTRIBUTIONS: HOW ARE THEY CALCULATED?



Required Minimum Distributions, commonly referred to as RMDs, are the government's way of collecting the taxes they have allowed workers to defer. Prior to reaching age 73, the government allows workers to defer income taxes on qualified assets by not requiring any qualified account distributions. Taking the time to understand these rules is essential for projecting your retirement income strategy.

Tax laws surrounding RMDs can be confusing. The IRS ensures retirees withdraw at least a portion of the funds in their retirement account over their lifetime, and that taxes are paid on those funds. Tax laws require owners of certain qualified investments, such as 401(k)s, traditional IRAs, qualified annuities and other employer provided qualified plans, to take RMDs after turning age 73. RMDs are calculated by dividing the prior year-end fair market value of the retirement assets by the applicable distribution period, also known as the RMD Factor.

**Calculation Example:** A retiree will be turning 76 in 2025 and has IRA assets totaling \$1,000,000 as of December 31st, 2024. During 2025, the client is required to take \$42,194 ( $\$1,000,000 / 23.7$ , see table) from their traditional IRA to satisfy their 2025 required minimum distribution. The retiree must make this RMD by December 31st, 2025.

If an individual fails to comply with RMD rules, the IRS will impose a 25% penalty in addition to withholding the taxes that would have been due from the distribution (penalty will be reduced to 10% if corrected within 2 years).

**Required Beginning Date (RBD):** The RBD is the latest date that a retiree can wait to satisfy their first RMD. For qualified assets, the Required Beginning Date is April 1st of the year after the individual reaches 73. There are two basic options to consider when you turn 73.

**Option 1 – Take one RMD:** During 2025, the retiree turns 73 with qualified assets of \$1,000,000 as of year end 2024. The retiree takes their first RMD of \$37,736 ( $\$1,000,000 / 26.5$ , see table) from his/her qualified retirement balances.

**Option 2 – Delay and take two RMDs:** During 2025, the retiree turns 73 with qualified assets of \$1,000,000 as of year-end 2024. The retiree wants to wait until the latest possible time to take their first RMD. In 2026, (the following year after the retiree reaches 73) the retiree is required to take the RMD for both 2025 and 2026. Assuming their qualified assets grew to \$1,100,000 at year-end 2024, their total RMD in 2026 would be:

$(\$1,000,000 / 26.5, \text{ see table}) = \$37,736$  (taken by April 1st, 2026)

$(\$1,100,000 / 25.5, \text{ see table}) = \$43,137$  (taken by December 31st, 2026)

This means that in 2026 the retiree would pay income tax on two RMDs in one year, potentially increasing their tax bracket. In most cases, it's better for the retiree to claim their first RMD in the year they turn 73.

Age	RMD Factor	RMD Percentage
73	26.5	3.77%
74	25.5	3.92%
75	24.6	4.07%
76	23.7	4.22%
77	22.9	4.37%
78	22.0	4.55%
79	21.1	4.74%
80	20.2	4.95%
81	19.4	5.15%
82	18.5	5.41%
83	17.7	5.65%
84	16.8	5.95%
85	16.0	6.25%
86	15.2	6.58%
87	14.4	6.94%
88	13.7	7.3%
89	12.9	7.75%
90	12.2	8.20%
91	11.5	8.70%
92	10.8	9.26%
93	10.1	9.90%
94	9.5	10.53%
95	8.9	11.24%
96	8.4	11.90%
97	7.8	12.82%
98	7.3	13.70%
99	6.8	14.71%
100	6.4	15.63%

For more details on IRA distribution rules please see IRS publication 590-B

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Many individuals find themselves in a position where they do not need to withdraw from these accounts after 73. For those looking for creative ways to avoid paying tax on their RMDs, below are some options to consider:

- **KEEP WORKING**

If you are working past 73 you will not be required to take RMDs from your current employers qualified plan. IRAs - including SEP and SIMPLE IRAs - as well as previous employer plans, will still require withdrawals to satisfy their RMDs after 73. If your plan document allows, you may roll over IRAs and previous qualified plans into your existing employer plan to prevent all RMDs.

Exception: If you own more than 5% of the company that sponsors the qualified plan, you will still be required to take RMDs from the account. This can potentially affect many business owners – such as lawyers, doctors and other professionals who practice past 73.

- **QUALIFIED CHARITABLE DISTRIBUTION (QCD)**

If you are at least 70½, the QCD rules allow you to distribute up to \$108,000 of your RMD to a qualified charitable organization. The amount given to the charity is not taxable to you. You will no longer be able to use that donation as an itemized deduction, but you can still claim a standard deduction. Any donation above your RMD will not be eligible to offset RMDs in future years.

To successfully make a Qualified Charitable Distribution, the distribution check must be made payable directly to the charitable entity. The Custodian of the IRA will be able to write the check directly to your charity. QCDs are an ideal way to lower your tax liability and fulfill your charitable intentions at the same time.

- **ROTH IRA CONVERSIONS: START EARLY**

IRS rules prohibit you from taking a RMD and reinvesting it into a Roth IRA. To contribute to a Roth IRA, you must either have earned income below the limits, or convert your traditional IRA to a Roth IRA. Although you will pay taxes in the year you convert the account into a Roth IRA, all future appreciation and income will not be subject to RMDs or taxation. There is no annual limit on how much you can convert.

To best take advantage of a Roth conversion, it's better to start converting before 73. If you wait until you are over age 73 to convert, you will still need to take the RMD in the year you convert. Making small conversions each year leading up to 73 will reduce your RMD liability, and increase your Roth assets that you can later withdraw tax-free.

- **QUALIFIED LONGEVITY ANNUITY CONTRACT (QLAC)**

QLACs are deferred annuities that provide lifetime income and lower your current RMDs. These are especially beneficial for individuals who are concerned about outliving their retirement assets, but have no need for their RMDs early in retirement. A QLAC allows you to defer your retirement assets up until age 85, and then provide a lifetime income stream (either single or joint).

The SECURE 2.0 Act increased the RMD age to 73 in 2023 and will again increase the RMD age to 75 in 2033.