PBS EpTBD AskPB RMDs Transcript Audio

Patti Brennan:

Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Today's podcast is part of the "Ask Patti Brennan" series. If we get questions on anything, it is about RMDs, required minimum distributions. The laws have changed many times over the past five years alone, and it is really complicated.

We're going to boil it down today and help you understand how they work and make sure that you're not making the mistakes that we've discovered over the years.

First and foremost, what are RMDs? Required minimum distributions have to come out of any kind of a retirement account, including 401(k)s, 403(b)s, IRAs. It is really important, because the law has changed. It depends on your year of birth.

For many people, the first year is age 73. If you are younger and were born after 1960, you don't have to take it out until you're 75. It is a formula-based requirement. The way you calculate it is, you have to look at the account value as of 12/31 of the prior year, apply this formula, and then take the money out.

Now, here's the way it works. If you have several IRAs in different custodians, different places, you can do the calculation and take the RMD out of one IRA. That's perfectly fine.

However, if you have IRAs in different places and a 401(k), you cannot take out the RMD that's from the 401(k). You have to take them out separately, from the IRAs as well as the 401(k).

401(k) plan providers will often send you the RMD amount, but a lot of times, you can't control which account it's being pulled from. That's a problem because markets go up, markets go down. Which fund are they going to pull it from?

If the stock market's going through a correction of 20 percent, you don't want to be selling low. You don't want to be selling when the market's already gone down 20 percent from that part of your 401(k). They typically will prorate the dollar amount.

Whereas if it's in your IRA, you can choose where you want to take the distribution from and when. You could take it monthly, quarterly, or you could take it at the beginning of the year and be done with it.

Many of you may have received retirement accounts from someone else, for example, a parent. That's called an inherited IRA. Please, please, please don't ever, ever co-mingle an inherited IRA with your other IRAs because the rules are different. Under the SECURE Act 2.0, an inherited IRA must be withdrawn over a period of 10 years.

It is really murky in terms of how you're supposed to pull it out. Do you pull out one-tenth per year? Or are you thinking, "You know what? We don't need the money right now. We'll wait until year six when we retire. As long as the account is out by year 10, we're good to go?"

Well, there have been recent publications that suggest that's not OK, that you should be taking out money from the inherited IRA each and every year. That's the way we're doing it, it's the more conservative approach, until we learn differently.

401(k)s are separate. IRAs can be together. You can take it out of one. 403(b)s are also separate. Inherited IRAs are subject to a whole different set of rules. Be aware of that.

The other question is we have some people who are continuing to work. "Hey, I'm happy in my job. I like working. I feel good about it. It's lower pressure," and they continue to work and contribute to the 401(k). That is perfectly fine. Actually, there's a neat little loophole that is encouraging people to continue to work.

If that is the case, you do not have to take a required minimum distribution out of your employer's 401(k). You have to take it out of everything else, but not that particular 401(k). Keep that in mind there is no need to pay taxes ahead of time.

Let's assume that you also want to do a Roth conversion in the year that you have to take an RMD. Understand, the RMD must come out first. Then you do the conversion. It's hard to understand these rules at times. It feels like sometimes the IRS is trying to trip us all up. What you don't know can really hurt you, so just know RMD's always must come out first.

From a practical perspective, let's say that you've consolidated all of your retirement accounts. You have one IRA and you've applied the proper formula. You know how much has to come out. You're going to do your payroll withholding, and you're going to do your tax withholding. Terrific.

Let's also assume that you're going to wait till the end of the year, see how you do in your other non-retirement accounts. Let's say it's a really good year and you've got capital gains and taxable income. You can choose to have a higher withholding amount on your RMD so you get the taxes over with. That's a practical tip.

We will often calculate what a person's tax bracket will be. Again, remember, we have a marginal tax system, so just because you might be in a 25 percent tax bracket, that doesn't mean 25 percent of the RMD has to be withheld. Part of it's going to be at 10 percent, part of it's going to be at 22 percent.

If you want to be conservative and over-withhold, this is a system that you can refine year after year. Please make sure that you understand what the rules are.

Again, whether your IRA's are consolidated or you have different IRA accounts, that RMD can be taken out of the one IRA. However, 401(k)s and 403(b)s must be separate. Inherited IRAs are a whole different ballgame, and they must come out over a period of 10 years, and you must always keep that in a separate account.

Those are the highlights of RMDs. We'll go into more details in another podcast. I wanted to go over some of the highlights because, again, you probably know this, the penalty for not doing this correctly is confiscatory.

Yes, we have a new law. The penalty is not as high as it used to be, but it's still pretty high. Please understand what the rules are. Contact your financial advisor for any clarification. Have them calculate it for you.

Thank you so much for joining me today. I am Patti Brennan. We are Key Financial, Wealth Management with Wisdom and Care. By the way, if you have questions, go to our website. We're at www.keyfinancialinc.com. We are happy to help any way we can. Thanks again for joining me today. Take care.