



Navigating Required Minimum Distributions

TAILORED STRATEGIES FOR
RMDs IN HIGH NET WORTH
SCENARIOS

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Strategic Considerations for High Net Worth Individuals in Required Minimum Distributions

A Required Minimum Distribution (RMD) mandates that individuals who reach a certain age are obligated to start taking minimum distributions from their tax-advantaged retirement accounts. The RMD provision was put into place to ensure funds within retirement accounts are used for their intended purpose — providing income during retirement, rather than deferring the funds in these tax-advantaged retirement savings accounts indefinitely.

High net worth (HNW) individuals often find themselves in a unique position when it comes to RMDs from their Individual Retirement Accounts (IRAs) and other retirement accounts such as a 401(k). These accounts can sometimes accumulate substantial balances for several reasons:

- **Consistent Maximization of Contributions:** Due to their wealth, HNW individuals frequently contribute the maximum allowed amounts to their IRAs and 401(k) accounts, maximizing their tax-advantaged savings.
- **More Aggressive Investment Style:** With a secure wealth base outside of retirement accounts, HNW individuals can adopt a more aggressive investment approach within their retirement accounts, as the tax implications are not immediately felt.
- **Delayed Withdrawal Patterns:** HNW individuals may postpone withdrawals from their retirement accounts, allowing funds to grow tax-deferred for an extended period.

Challenges can arise when individuals with substantial retirement account balances reach the age at which current tax legislation mandates that RMDs must be taken. This seemingly routine requirement can clash with the primary goal of wealth preservation for future generations.

In this report, we will cover the unique challenges that can arise for ultra high net worth (UHNW) individuals when they reach the age of required RMD distributions, as well as some of the tactics that can be considered to mitigate the impact RMDs have on a wealth strategy.

Navigating the Challenges of RMDs and Evolving Age Requirements

It is essential for individuals to be aware of and comply with RMD rules to avoid penalties and ensure the appropriate management of their retirement assets. RMD rules typically apply to tax-advantaged retirement accounts, including Traditional IRAs, SEP IRAs, SIMPLE IRAs, 401(k)s, 403(b)s, and certain other qualified retirement plans. Failure to take the required minimum distribution can result in significant penalties — under the Secure Act 2.0, there is a 25% excise tax on the RMD amount not withdrawn, and it is assessed on the amount that should have been withdrawn but wasn't — highlighting the importance of adhering to RMD rules in managing retirement accounts.

The specific age at which RMDs must begin has been changed in recent years. Between 1982, when RMDs were initially implemented, and 2019, that age stood at 70½. That age requirement slid up to 72 years old in 2019 and was once again adjusted as defined by the SECURE 2.0 Act of 2022, delaying the RMD age from 72 to 73. In 2033, the RMD age will increase to age 75.

For many individuals, the implications of taking an RMD are minor. For UHNW clients with substantial retirement account balances, there are factors that must be considered during this process:



- **Tax Implications:** An RMD is generally subject to income tax, potentially pushing individuals into higher tax brackets and increasing their tax liabilities.
- **Portfolio Allocation:** Managing RMDs can disrupt carefully planned asset allocations, potentially requiring the sale of assets at unfavorable times.
- **Wealth Preservation:** For those focused on preserving wealth for future generations, RMDs can conflict with this goal by reducing the size of tax-advantaged retirement accounts.
- **Complex Financial Structures:** HNW individuals often have intricate financial structures involving multiple retirement accounts, trusts, and other investment vehicles. Coordinating RMDs across these entities requires specialized expertise.
- **Estate Planning Considerations:** RMDs are integral to estate planning. HNW individuals need to consider how RMDs fit into their broader estate planning strategy, including minimizing tax impacts on heirs.
- **Market Volatility:** RMD timing may coincide with market volatility, affecting individuals relying on these distributions for income and potentially impacting financial well-being.
- **Charitable Giving Objectives:** Individuals with philanthropic goals may struggle to align RMDs with charitable giving objectives.

Strategic RMD Approaches HNW Individuals Can Consider

We've covered a lot of ground thus far, and you probably know more now about RMDs than you ever cared or wished to know. While there comes the point where these distributions must begin to avoid large penalties, several strategies can be utilized to ensure this process aligns with your broader financial goals and can potentially minimize the tax implications.

Of course, before deploying any of these strategies, it's important to consult with your financial, tax, and legal advisors to ensure your personal situation is suitable for any of them.

Make Qualified Charitable Distributions

One of the simplest tactics to deploy when it comes time to take an RMD is to donate those funds directly to a qualified charity. Called Qualified Charitable Distributions (QCDs), this provision allows account holders to distribute funds from their IRAs directly to qualified charities. The benefit of this strategy is that it fulfills the RMD requirement without adding the value of the distribution to an individual's taxable income for the year.

A key aspect of this strategy is that the QCD must flow directly from the retirement account to the charity. Suppose the distribution is deposited into the taxpayer's bank account. In that case, its donation to the charity is counted only as a tax-deductible event, minimizing the impact on the overall taxable liability for the year.

An additional benefit is the removal of the distribution from the taxpayer's adjusted gross income (AGI), positively impacting Medicare premium costs. It is important to note that QCDs cannot be made to Donor Advised Funds.

Convert Your IRA to a "Backdoor" Roth Account

Roth IRAs are a great wealth strategy tool because the investments in a Roth account grow tax-free. Roth accounts are also not subject to RMDs during the lifetime of the original account owner. However, the IRS has placed limits on who can contribute to a Roth IRA account based on adjusted gross income — an income level far below what many of our clients earn in a given year.

The Backdoor Roth strategy provides a workaround for high-income individuals who have income levels that make them ineligible to make direct contributions to a Roth IRA. This technique involves making non-deductible contributions to a Traditional IRA and subsequently converting those contributions to a Roth IRA. The process begins with contributing to a Traditional IRA with after-tax dollars, making the contribution non-deductible. Shortly after, individuals convert the Traditional IRA funds to a Roth IRA, treating the conversion as a Roth conversion.

It's important to note that while the initial contribution is made with after-tax dollars and is not tax-deductible, the conversion to a Roth IRA may trigger taxes if there were any earnings on the contributed amount before the conversion. This strategy is particularly useful for those seeking to continue contributing to a Roth IRA despite income limitations.

It is crucial to address potential tax implications associated with this strategy, and consulting your CPA is strongly advised before proceeding. One noteworthy consideration is the pro-rata rule, a formula applied when an IRA account contains both pre-tax and after-tax dollars. This rule is often described using the 'Cream in the Coffee' analogy, highlighting that once cream is introduced into coffee, the two become inseparable.

Similarly, with pre-tax and after-tax dollars, each distribution involves a blend, and your CPA will play a key role in assessing the tax impacts of each distribution.



What Studebaker Has to Do with Your Retirement Accounts

For the history buffs among us, we thought you might find it interesting to know that your retirement accounts came about as a direct result of the closure of the Studebaker-Packard Corporation plant in South Bend, Indiana.

On December 20, 1963, the Studebaker-Packard Corporation ceased operations of the South Bend plant, where they had manufactured automobiles since 1902. When the plant closed its doors, that event had far-reaching consequences, not just for the local community and the automotive industry but for the entire retirement benefits structure of the country. The employee pension plan for those employees working at the plant was insufficiently funded. That meant that not only did the workers in that plant suddenly find themselves without employment, but they also lost the expected pension benefits they had worked for.

The South Bend Studebaker plant closure resulted in a tremendous amount of public outcry and set the legislative path toward regulatory measures to govern employer-sponsored retirement plans and safeguard the interests of plan participants. In 1974, the Employee Retirement Income Security Act (ERISA) was voted into law and established a framework for the responsible management of retirement benefits. The ERISA law included the framework for the IRA and set the groundwork for introducing the 401(k) plan that came about through the Revenue Act of 1978.

These changes represented a significant change in how Americans planned for and saved for their retirement. These laws shifted the focus away from traditional employer-funded pension plans. They placed a greater level of control and responsibility on the shoulders of the individual to manage their contributions and employee-directed investment choices.



Qualified Longevity Annuity Contract

Another avenue HNW individuals can take to navigate RMD challenges is using an instrument called a Qualified Longevity Annuity Contract (QLAC). A QLAC is a type of annuity that is designed to provide a guaranteed stream of income during an individual's later years while also complying with IRS regulations and RMD rules.

Retirees can use funds from their 401(k) or IRA account to purchase an annuity, allowing for payments to start at a date of their choosing, provided it begins before they turn 85. This is significantly later than the minimum RMD age of 73 for the accounts. Once the QLAC starts making payments, it provides a guaranteed stream of income that continues for the individual's lifetime.

The most notable benefit to a QLAC is the amount of money invested in a QLAC is excluded from the calculation of RMDs from the retiree's tax-advantaged retirement accounts. This exclusion allows individuals to allocate a portion of their retirement savings to a QLAC without triggering immediate RMDs on that portion. For the year 2024, individuals can contribute up to \$200,000 to a QLAC, allowing them to exclude a corresponding amount from their RMDs.

It's essential to understand that as an annuity, there is a possibility that not all the money will be utilized if the individual passes away after starting payments. An estate planning benefit introduced by the SECURE 2.0 Act is the inclusion of a "return of premium" feature in QLACs. This feature ensures that the purchase amount, less any payouts, goes to a designated beneficiary upon the individual's passing.

In Conclusion...

Effectively managing RMDs is crucial for HNW individuals seeking to preserve their wealth. By implementing tailored solutions such as QCDs, the Backdoor Roth, and QLACs, individuals can strategically navigate the complexities of RMDs and mitigate their impact on long-term financial plans.

Of course, it is essential for individuals considering any of these strategies to understand the specific terms and features of each approach and consult with financial professionals to assess whether it aligns with their retirement goals and financial situation. Additionally, tax laws and regulations may change, so it's advisable to stay informed about any updates that may affect their plans.

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