Lower Taxes on Your RMDs

When you turn 72, you'll have to start taking minimum distributions from your IRA and 401(k). These strategies will help trim Uncle Sam's take.

BY SANDRA BLOCK

The buoyant stock market has swelled the amount of money Americans have in their retirement savings plans, which is undoubtedly a welcome development for seniors who will need that money to live on. But most of the more than $13 trillion in savings is stockpiled in tax-deferred plans, which means retirees will eventually have to pay taxes on it. And depending on the size of the account, that tax bill could be significant.

To prevent retirees from avoiding taxes forever, the IRS requires owners of traditional IRAs and other tax-deferred accounts, such as 401(k) plans, to take minimum withdrawals based on their life expectancy and the balance of their accounts at year-end. The Setting Every Community Up for Retirement Enhancement (SECURE) Act, which was signed into law in December 2019, increased the age at which you must begin withdrawing money from 70½ to 72. Legislation pending in Congress would gradually increase the age for required minimum distributions to 75 by 2032 (see the box on page 60).

PHOTOGRAPH BY MARTY LEE

But unless Congress decides to eliminate RMDs altogether, which seems unlikely, you (or your heirs) will eventually have to withdraw the money in your tax-deferred accounts. And that could be a problem, because as your untapped balance grows, so does the amount you'll be required to withdraw, along with your tax bill. RMDs are taxed as income, so a large withdrawal could vault you into a higher tax bracket. In addition, more of your Social Security benefits could be taxed, you could lose out on certain deductions and credits tied to your modified adjusted gross income, and you could pay higher premiums for Medicare parts B and D.

Below we describe ways to reduce the size of your required withdrawals and, consequently, your tax bill. All involve trade-offs—paying taxes now instead of later, for example, or giving some of your savings away—so consider your options carefully.

TAP YOUR IRA FOR CHARITY

If you're 70½ or older, you can donate up to $100,000 a year from your IRAs to charity via a qualified charitable distribution, and after you turn 72, the QCD will count toward your required minimum distribution. A QCD isn't deductible, but it will reduce your adjusted gross income, which besides lowering your federal and state tax bill can also lower taxes on items tied to your AGI, such as Social Security benefits and Medicare premiums. If you don't itemize—which is the case for many retirees—a QCD provides a way to get a tax break for your charitable gifts.

David Bayer, 89, a former Navy captain who lives in John Knox Village, a retirement community in Pompano Beach, Fla., has been making qualified charitable distributions from his retirement savings since he turned 70½. His wife, Jackie, who is 75, also started making QCDs when she was required to start taking withdrawals from her savings. The Bayers contribute to several philanthropic causes, including their church and an organization that supports orphanages in Africa. Jackie also used a QCD to set up a scholarship fund at Purdue University, her alma mater.

"We feel that we're at a spot where we're fortunate to be able to give back," David Bayer says. "It's nice to know that Uncle Sam is chipping in his share."

The maximum amount you can donate each year through a QCD is $100,000, but you can donate less than that, and many retirees do. Randy Bruns, a CFP in Napierville, Ill., says he often advises retirees who are already making charitable contributions to channel their gifts through a QCD.

Make sure the donation is made directly from your IRA to the charity; otherwise, it won't qualify for a QCD. You can't make a QCD to a donor-advised fund or private foundation, and the recipient must be a 501(c)(3) charity registered with the IRS, says Mari Adam, a CFP with Mercer Advisors in Boca Raton, Fla. That's not always clear: Adam says she recently discovered that a philanthropic group she has supported was not a qualified charity (it subsequently registered with the IRS). Check the charity's website, or ask the organization for a tax identification number.

Keep good records so that you won't be taxed on the distribution when you file your tax return. Most tax software, or your tax preparer, will walk you through the process to report your QCD.

CONVERT TO A ROTH

When you convert money in a traditional IRA to a Roth, you must pay taxes on the amount you convert (although part of the conversion won't be taxed if you've made nondeductible contributions to your IRA). But after the conversion, all withdrawals are tax-free, as long as you're 59½ or older and have owned a Roth for at least five years. Unlike traditional IRAs and other tax-deferred accounts, Roths aren't subject to required minimum distributions, so if you don't need the money, you can let it continue to grow, with no obligation to the IRS.

Converting to a Roth is also a hedge against future tax increases. The Biden administration has proposed increasing the top tax rate on ordinary income from 37% to 39.6%

Postpone Distributions Until Age 75?

Congress isn't finished tweaking the rules for retirees. Legislation dubbed SECURE Act 2.0 would make a number of changes to the rules governing retirement savings, including the age at which required minimum distributions start.

The proposed legislation would raise the RMD age from 72 to 73 starting on January 1, 2022; to age 74 on January 1, 2029; and to 75 on January 1, 2032.

Proponents of a higher age for RMDs argue that life expectancies have increased since RMDs were created, which means seniors need more time for their money to grow. In the mid 1970s, when the Employee Retirement Income Security Act, or ERISA, first authorized IRAs, U.S. life expectancy at birth was 72.6 years, according to the Centers for Disease Control and Prevention. While life expectancy declined between 2019 and 2020, primarily due to the pandemic, it's still much higher, at 77.3 years, and many seniors live well beyond that average.

Another provision in SECURE Act 2.0 would greatly reduce the penalty for failing to take a mandatory withdrawal. Currently, the penalty is 50% of the amount you should have withdrawn, one of the harshest penalties in the tax code (although you can qualify for a waiver, depending on your circumstances). The legislation would reduce the penalty to 25%, and if the mistake is corrected in a timely manner, it would be further reduced to 10%.

for joint filers with taxable income of more than $450,000 and single filers with taxable income of more than $400,000. And even if those proposed tax rates fail to get through Congress, the 2017 Tax Cuts and Jobs Act, which lowered income tax rates across the board, is scheduled to sunset in 2025. Unless it's extended, tax rates will revert to their higher, pre-2017 levels. "We tell our clients, 'You may never see tax rates this low in your lifetime,'" Bruns says. Plus, if you expect to leave funds in your IRA to your children, converting to a Roth could lower the taxes they'll pay on their inheritance (see the box at right).

However, a large Roth conversion, like a large RMD, could push you into a higher tax bracket, increase taxes on Social Security benefits, and trigger a high-income surcharge on your Medicare premiums. And it doesn't make much sense to convert if you're in a high tax bracket now and expect to be in a lower one in the future.

"My advice on this is, don't aim too big," because you may live to regret it, Adam says. She says her clients usually convert fairly modest amounts—typically $10,000 to $20,000 a year. Before 2018, taxpayers who converted an IRA to a Roth had until the tax extension deadline of the year following the year they converted—typically October 15—to change their minds. That's no longer permitted, so it's important to get it right the first time.

You can keep the cost of a conversion down by converting during the period between the year you retire and the year you're required to take RMDs. Your income will likely drop after you stop working, and until you're required to start taking distributions, you have some control over the amount of income you receive each year. With the help of a financial planner (or a good software program), you can calculate how much you can convert without moving into a higher tax bracket. Once you've started taking RMDs, you can't convert money in a traditional IRA (or other tax-deferred accounts) to a Roth until you've taken your required distribution, which could result in a hefty tax bill.

OTHER STRATEGIES

Even if you don't need the money, taking small distributions from your tax-deferred accounts during your low-tax years could be a smart tax-planning strategy. The distributions will reduce the size of accounts, which will mean smaller RMDs down the road, says Kristin McKenna, a CFP with Darrow Wealth Management in Boston. As is the case with Roth conversions, it's a good idea to figure out how much you can withdraw each year while remaining in your current tax bracket.

Taking early distributions offers other benefits. You can use the extra income to delay filing for Social Security, ideally until age 70, so you can take advantage of delayed retirement credits. And as is the case with conversions, you'll be able to take advantage of current low tax rates.

Another way to reduce RMDs is by buying a deferred income annuity. You can invest up to 25% of your IRA or 401(k) account (or $135,000, whichever is less) in a type of deferred income annuity known as a qualified longevity annuity contract (QLAC). When you reach a specified age, which can be as late as 85, the insurance company turns your deposit into payments that are guaranteed to last the rest of your life.

The portion of savings used for the annuity is excluded from the calculation to determine your RMDs. For example, if you have $500,000 in an IRA and transfer $100,000 into a QLAC, your RMD is based only on the remaining $400,000. This doesn't eliminate your tax bill—it just defers it. The taxable portion of the money you invested will be taxed when you start receiving income from the annuity.

QLACs offer other advantages to retirees who want guaranteed income later in life. Because you're deferring the income stream, payouts are much higher for deferred income annuities than they are for immediate annuities, which start payouts right away. For example, a 65-year-old man who invests $100,000 in an immediate annuity will receive a payout of $493 a month, according to www.immediateannuities.com. That same amount invested in a deferred-income annuity that begins payments at age 80 would pay $1,663 a month. ■

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YOUR LEGACY

Smart Planning

The first SECURE Act may have provided a break for retirees who need more time for their savings to grow, but it could increase taxes on funds they leave to their heirs.

Before 2020, beneficiaries of inherited IRAs (or other tax-deferred accounts, such as 401(k) plans) could transfer the money into an account known as an inherited (or "stretch") IRA and take withdrawals over their life expectancy. That enabled them to minimize taxable withdrawals and allow the untapped funds to continue to grow.

Now, most adult children and other non-spouse heirs who inherit an IRA (or inherited one on or after January 1, 2020) must deplete their inherited IRAs within 10 years after the death of the original owner (see "The Inheritance Challenge," Dec.). Spouses still have the option of rolling the money into their own IRAs or taking distributions based on their lifetimes.

Non-spouse heirs who inherit a Roth also have to empty the account in 10 years, but the distributions are tax-free. If you want to leave your adult children a tax-free legacy, converting some of your IRA funds to a Roth could be a smart estate-planning strategy. But the strategy's value depends on your family's financial circumstances. If your heirs are in a lower tax bracket than you are, you may be better off leaving them a traditional IRA—and the tax bill.

CREDIT

What to Do If Your Credit Card Is Closed

ACCORDING TO A REPORT from the Consumer Financial Protection Bureau, even good borrowers experienced an uptick of account closures from March to June of 2020. If you were part of the inactivity cull, you may be able to remedy the situation—especially if it's a card that you relied on as a backup. Plus, a canceled credit card may ding your credit score because it reduces the amount of available credit.

> **RATE UPDATES**
> For the latest savings yields and loan rates, visit **kiplinger.com/links/rates.** For our top rewards cards, go to **kiplinger.com/kpf/cards21.**

Your credit card issuer is not likely to tell you if it plans to close your account. However, if you've signed up with a credit-monitoring service such as Credit Karma, you may receive an alert. If that happens, call your issuer right away to see how to get your card reinstated. The issuer may restore your account with the previous terms, or it may request that you reapply for the card. If you lost points because of the closure, ask if those can be reinstated as well—although the issuer has no obligation to do so. If your card is restored with a lower credit limit, wait six months and then ask for an increase.

In general, credit card issuers don't want to close your account, because it's hard to find and keep a good customer, says credit expert John Ulzheimer, author of *The Smart Consumer's Guide to Good Credit*. Use cards you want to keep just often enough to keep them active. You could use the card to automatically pay a recurring bill, such as your gym membership or a subscription. When the bill comes in, pay the entire balance to avoid triggering interest charges. Or shop around for a card that has a lower rate or a rewards program that's better suited to your spending habits (see kiplinger.com/kpf/cards21).

If your credit score took a hit, reinstating your old credit card or applying for a new one should boost your score. When an account is closed, the amount of available credit decreases, which impacts your credit-utilization ratio—the amount you owe as a percentage of your total available credit. This ratio accounts for 30% of your credit score. It's best to keep your balances around 30% or less of your available credit. **RIVAN STINSON**
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TOP-YIELDING SAVINGS

Taxable Money Market Mutual Funds	30-day yield as of Nov. 2	Minimum investment	Website (www.)
Transamerica Govt MMF (IATXX)*	0.46%	$1,000	transamerica.com
Schwab US Treasury MF (SNSXX)*	0.13	1	schwab.com
BlackRock Liqdty FdFnd (BFBXX)*	0.03	1	blackrock.com
Delaware Ivy Govt MMF (WRAXX)*	0.03	750	ivyinvestments.com

Tax-Free Money Market Mutual Funds	30-day yield as of Nov. 1	Tax eq. yield 24%/35% bracket	Minimum investment	Website (www.)
American Cent T-F MMF (BNTXX)*	0.01%	0.01%/0.02%	$2,500	americancentury.com
BNY Mellon Ntl Muni (MOMXX)*	0.01	0.01/0.02	10,000	im.bnymellon.com
Fidelity Muni MMF (FTEXX)*	0.01	0.01/0.02	1	fidelity.com
Fidelity Tax-Exempt (FMOXX)*	0.01	0.01/0.02	1	fidelity.com

Savings and Money Market Deposit Accounts	Annual yield as of Nov. 5	Minimum amount	Website (www.)
Affinity Plus FCU (Minn.)&#	1.00%^	none	affinityplus.org
Bo Bank (N.J.)†	0.65	$250	bankwithbo.com
Ivy Bank (Mass.)†	0.61	2,500	ivybank.com
Connexus Credit Union (Wis.)&#µ	0.60	1,000	connexuscu.org

Certificates of Deposit 1-Year	Annual yield as of Nov. 5	Minimum amount	Website (www.)
US Alliance Financial (N.Y.)&§	0.85%	$500	usalliance.org
Lafayette FCU (Md.)&	0.80	500	lfcu.org
EFCU Financial (La.)&	0.80	500	efcufinancial.org
Live Oak Bank (N.C.)†	0.75	2,500	liveoakbank.com

Certificates of Deposit 5-Year	Annual yield as of Nov. 5	Minimum amount	Website (www.)
Lafayette FCU (Md.)&	1.26%	$500	lfcu.org
Affinity Plus FCU (Minn.)&	1.25	500	affinityplus.org
EFCU Financial (La.)&	1.25	1,000	efcufinancial.org
Pentagon FCU (Va.)&	1.25	1,000	penfed.org

*Fund is waiving all or a portion of its expenses. &Must be a member; to become a member, see website or call. #Money market deposit account. ^Must receive electronic statements and have a $500 monthly direct deposit into an Affinity Plus deposit account. †Internet only. µPrime Alliance Bank has a similiar yield. §Must open a checking or savings account. SOURCES: Bankrate, DepositAccounts, Money Fund Report (iMoneyNet).

TOP CHECKING ACCOUNTS

Must meet activity requirements*

High-Yield Checking	Annual yield as of Nov. 5	Balance range†	Website (www.)
La Capitol FCU (La.)&	4.25%	$0–$3,000	lacapfcu.org
Consumers Credit Union (Ill.)&	4.09‡	0–10,000	myconsumers.org
Genisys Credit Union (Mich.)&	4.07	0–7,500	genisyscu.org
Liberty Financial (Ind.)&	3.30	0–20,000	liberty.financial

*To earn the maximum rate, you must meet requirements such as using your debit card several times monthly and receiving electronic statements. †Portion of the balance higher than the listed range earns a lower rate or no interest. &Must be a member; to become a member, see website. ‡Requires spending $1,000 or more monthly in CCU Visa credit card purchases. SOURCE: DepositAccounts

YIELD BENCHMARKS

	Yield	Month-ago	Year-ago
U.S. Series EE savings bonds	0.10%	0.10%	0.10%
U.S. Series I savings bonds	7.12	3.54	1.68
Six-month Treasury bills	0.07	0.06	0.10
Five-year Treasury notes	1.04	0.98	0.33
Ten-year Treasury notes	1.45	1.54	0.79

As of November 5, 2021.
- EE savings bonds purchased after May 1, 2005, have a fixed rate of interest.
- Bonds purchased before May 1, 1995, earn a minimum of 4% or a market-based rate from date of purchase.
- Bonds bought between May 1, 1995, and May 1, 2005, earn a market-based rate from date of purchase.