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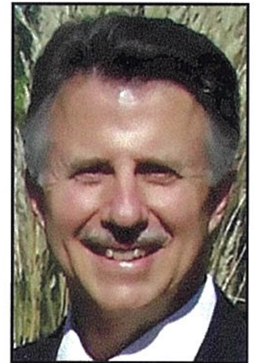

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A New Landscape for RMDs

By Ed Slott, CPA

The SECURE 2.0 Act, part of the federal spending bill passed in late 2022, included important changes to the required minimum distribution (RMD) rules that apply to tax-deferred retirement accounts. First and foremost, the Act increased the age to begin RMDs, providing the option to leave your retirement savings untapped — and untaxed — for longer.

More Time to Grow

Contributions to tax-deferred retirement accounts are either made with pre-tax dollars, typically through a payroll deduction, or are tax deductible (up to the annual limit) if made directly. These accounts include traditional IRAs, SIMPLE IRAs, SEP IRAs, SARSEPs, and 401(k), 403(b), and government 457(b) plans.

Unfortunately, you cannot defer taxes forever on the money you've accumulated in these accounts. You are required to take minimum distributions each year once you reach a certain age, whether you need the money or not. The RMD is the smallest amount you must withdraw each year, but you can always take more.

SECURE 2.0 raised the RMD starting age to 73 for those born from 1951 to 1959 and to 75 for those born in 1960 or later. If you were born in 1950 or earlier, you are already required to take annual RMDs. If you are still employed, you may be able to delay taking RMDs from your current employer's plan until after you retire.

You are required to take minimum distributions from tax-deferred retirement accounts each year once you reach a certain age, whether you need the money or not.

Because Roth contributions are made with after-tax dollars, Roth IRA owners are not required to take lifetime RMDs. (Beneficiaries have different rules.) And fortunately, SECURE 2.0 extended this treatment to Roth accounts in employer-sponsored plans, effective for tax year 2024 and later.

Distribution Deadlines

Even though you must take an RMD for the tax year in which you turn 73 (or 75), you have a one-time opportunity to wait until April 1 of the following year to take your first distribution. For example, if you turn 73 in 2024, you must take an RMD for 2024 no later than April 1, 2025. You must then take your 2025 distribution by December 31, 2025, your 2026 distribution by December 31, 2026, and so on.

While it may be helpful in some cases to wait until the following year to take your first RMD, taking two RMDs in one year could put you in a higher tax bracket. It's important to plan ahead and not be forced to take two distributions in one year just because you forgot to take the first one.

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If you have any questions about the topics in this newsletter or about your financial future, call us. We are available to help.

Managing Medicare Out-of-Pocket Costs

Medicare covers only 60% of total health-care costs for Americans age 65 and older.[1] Deductibles, copays, coinsurance, and payments for services not covered by Medicare can result in substantial out-of-pocket expenses. And there is no annual or lifetime out-of-pocket limit.

Whether you are already enrolled in Medicare or planning to enroll in the future, you may want to consider two options to help manage out-of-pocket costs: Medigap and Medicare Advantage. Both are offered by private insurance companies approved and regulated by Medicare. They are mutually exclusive — you cannot be covered by both — but either might provide more stability to your health-care spending in retirement.

Supplemental Insurance

Medigap supplements coverage under Original Medicare Part A (hospital insurance) and Part B (medical insurance), and you must be enrolled in Part A and Part B in order to buy a Medigap policy. These policies pay nearly all or a percentage of Medicare out-of-pocket costs such as deductibles, copays, and coinsurance. Some plans may pay for services not covered by Medicare, such as emergency medical care outside the United States (up to plan limits), but they generally do not cover long-term care, vision or dental care, hearing aids, or private-duty nursing. New Medigap policies do not cover prescription drugs, so you must enroll in Medicare Part D if you want prescription drug coverage.

You can enroll in a Medigap plan at any time, but the best time to do so is during the initial Medigap open enrollment period — the six-month period that begins on the first day of the month in which you are 65 or older and enrolled in Medicare Part B. During this time, you can buy any Medigap policy in your state for the same premium the insurance company charges to healthy enrollees, even if you have health problems. If you miss this opportunity, a company can charge you more for coverage or refuse coverage altogether, depending on your health. Medigap policies are guaranteed renewable; once you are enrolled, you cannot be denied coverage or charged more than healthy enrollees due to changes in your health, as long as you pay your premium.

A Medigap policy covers only one individual, so you and your spouse need separate policies if you both want coverage.

All-in-One Coverage

Medicare Advantage (MA) Plans, also called Medicare Part C, replace Original Medicare Part A and Part B and often offer prescription drug coverage, similar to Medicare Part D. Benefits are provided through a private insurance company, but much of the funding comes from the federal government, and plans must offer the same benefits as Original Medicare.

MA plans generally encourage the use of network providers and have higher costs for out-of-network services. They may offer additional benefits not covered by Original Medicare, such as dental care, eyeglasses, and wellness programs. You will typically pay your Medicare Part B premium and may pay an additional premium, depending on the plan. You may also have out-of-pocket deductibles, copays, and coinsurance. However, all MA plans have an annual out-of-pocket maximum.

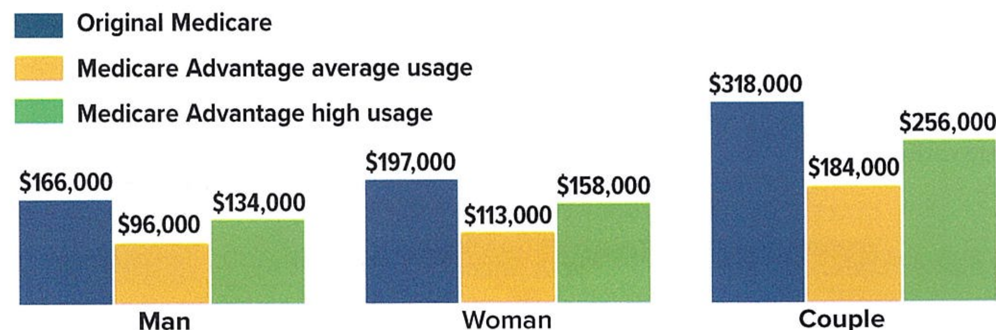
You can enroll in an MA plan instead of Original Medicare during your initial Medicare enrollment period.[2] You can change coverage from Original Medicare to MA or vice versa, or change between MA plans, during the Medicare Open Enrollment period from October 15 to December 7. You can change from MA to Original Medicare or switch MA plans during the Medicare Advantage Open Enrollment period from January 1 to March 31. You may also be able to make changes during other special enrollment periods.

For more information on Medigap, Medicare Advantage, and enrollment periods, see ***Medicare.gov***.

1) Employee Benefit Research Institute, 2023
2) Initial Medicare enrollment period is the seven-month period beginning three months before the month you turn 65 and ending three months after the month you turn 65. Special enrollment rules apply if you have health insurance through your own or your spouse's employment.

Saving for Retirement Health Care

This chart shows the savings that a man, a woman, and a couple who retired at age 65 in 2022 might need to meet retirement health-care expenses, assuming median prescription drug expenses. Medicare Advantage Plans can reduce out-of-pocket expenses, but they often have limited networks and may require approval to cover certain medications and services.



Source: Employee Benefit Research Institute, 2023. Projections are based on a 90% chance of meeting expenses and assume savings earn a return of 7.32% from age 65 until expenditures are made. Does not include vision, hearing, dental, or long-term care expenses. Original Medicare estimate includes premiums for Medicare Parts B and D, the Part B deductible, out-of-pocket prescription drug spending, and premiums for Medigap Plan G, which would pay most other out-of-pocket costs. Some Medicare Advantage plans require additional premiums, which are not included.

Four Key Objectives of a Sound Retirement Plan

A sound retirement plan should be based on your particular circumstances. No one strategy is suitable for everyone. Once you're retired, your income plan should strive to address four basic objectives: earn a reasonable rate of return, manage the risk of loss, maintain a source of sustainable and predictable income, and reduce the impact of taxes.

Earn a Reasonable Rate of Return

Your retirement savings portfolio will likely be used to provide at least a portion of your income throughout retirement. The overall goal is to maintain an amount that produces the necessary income each year. This requires accounting for the rising costs of goods and services (including health-care expenses); identifying your budgetary needs and wants; estimating how long you'll expect retirement to last; and factoring in Social Security and other income sources. It also requires estimating a rate of return you'll need to earn on your portfolio and then putting together an investment strategy to pursue that target rate.

While we'd all like to achieve a 30%–40% annual return on our retirement savings, for most of us that isn't practical. If you have enough savings to meet your retirement needs, you'll want to maintain that level of savings throughout your retirement years. That's why it's important to strive for a realistic rate of return on those savings. Of course, determining a reasonable rate of return depends on your individual circumstances and goals.

Manage Risk of Loss

If you have sufficient savings to meet your retirement needs and goals, you'll want to protect those savings and reduce the risk of loss due to sudden market corrections and volatility. The goal is to reduce investment risk and preserve savings. A reduction in savings due to a market downturn could require you to sacrifice important retirement goals and reduce retirement income.

Prior to retirement, you have more time to recover from market losses. However, once retired, your time frame for recovery is much shorter. For example, if you had retirement savings of $500,000 and lost 25% due to market volatility, your savings would be reduced to $375,000. You would have to earn a rate of return of more than 33% in order to get back to $500,000. That could take plenty of time to achieve.

Maintain a Sustainable and Predictable Income

During our working years, most of us are used to receiving a steady income. However, once we retire, the income we got from work is no longer there, even though that's what we've been accustomed to. So it's important to create a sustainable, dependable income stream in retirement to replace the income we received during our working years. While you may receive Social Security retirement benefits, it's unlikely that you can maintain your desired lifestyle in retirement on just Social Security. In addition, defined-benefit pension plans are not as prevalent or available as they once may have been. Most employers don't offer pension plans, placing the burden on us to find our own sources of retirement income.

Maintaining a sustainable income in retirement is important for many reasons. You'll want sufficient income to meet your retirement expenses. It is also important that your income is not negatively impacted by downturns in the market. And you'll want your income to last as long as you do.

A Few Words About Retirement

In a recent survey, retirees ages 40 to 74 were asked to choose from a list of words and short phrases to describe their feelings about retirement. The good news is that most had positive feelings.

Source: AARP, 2022 (multiple responses allowed)

Reduce the Impact of Taxes on Retirement Income

Taxes can cut into your retirement income if you don't plan properly. Many of us think our tax rate will be lower in retirement compared to our working years, but that is often not the case. For instance, we may no longer have all of the tax deductions in retirement that we had while working. In addition, taxes may increase in the future, potentially taking a bigger chunk out of your retirement income. So it's important to create a tax-efficient retirement.

Your retirement plan should be suited to your particular situation. However, these four objectives are often part of a sound retirement plan. A financial professional may be able to help you to earn a reasonable rate of return, manage risk of loss, create and maintain predictable retirement income, and reduce the impact of taxes on that income. (There is no guarantee that working with a financial professional will improve investment results.)

Leave a Lasting Gift with an Ethical Will

A legal will describes how you want your material assets to be distributed, but how do you leave behind your values? Using an ethical will, also called a legacy letter, you can tell your personal story and communicate your beliefs and life lessons to your family, friends, or community. You can opt to share it during your lifetime or leave it as a special gift for your loved ones to cherish after you're gone.

Despite the name, an ethical will isn't a legal document, and though often written, it can be in any creative format you choose. You might make a video or audio recording, create a photo album or a scrapbook, write and record a song, or put together a collection of recipes.

There are no rules that dictate what to include. For example, you might decide to write a few pages recounting meaningful family stories, while adding personal notes of love and gratitude. You might share challenges you've overcome or explain why you made certain decisions. You could tell your children how they have enriched your life or simply record a brief message to inspire future generations.

No matter which format you choose and what you decide to say, consider keeping the tone positive and helpful. Think about how your message might be received, and how future generations might benefit from what you have to say.

The process of writing an ethical will may seem daunting, but it can also be rewarding as you reflect on your experiences and what you truly value. Here are a few questions to help you get started.

- What principles guide your life?
- What are you most grateful for?
- How would you like to be remembered?
- How have specific experiences or events shaped you?
- What are some important choices you've made?
- How have you treated others, and how have others treated you?
- What have you not had the chance to say?
- Who were the most influential or admirable people in your life?
- Which charitable organizations are most important to you and why?
- What are your hopes for future generations?

If you need further information and inspiration, you can find samples, templates, books, and workshops online. Your attorney may also help guide you.

Once you've crafted your ethical will, make sure it's preserved in digital or printed form, or both. Share it now, or keep it with other estate documents, such as a copy of your legal will and advance care directives, and tell others where to find it.

A New Landscape for RMDs

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If you do not take all or part of your RMD, the amount not withdrawn is subject to a 25% penalty. SECURE 2.0 reduced this from 50%, but it remains one of the steepest penalties in the U.S. tax system. The penalty is reduced to 10% if "timely corrected" by making up the missed RMD, generally in two years unless the penalty is assessed earlier.

How Much to Take

Annual RMDs are based on the account balances of all your traditional IRAs and employer plans as of December 31 of the previous year, your age in the current tax year, and your life expectancy as defined in IRS tables. These tables were updated in 2022 to reflect longer life expectancies, which reduced the RMD at any given age. To calculate your RMD, divide the value of each retirement account balance as of December 31 of the previous year by the distribution period in the appropriate IRS table.

If you have multiple tax-deferred accounts, calculating RMDs can be complex — one reason why it may be helpful to consolidate your retirement accounts. The IRA custodian or administrator of your retirement plan may provide information regarding your RMD for a specific account, but you might also consult with your tax professional. Ultimately, you are responsible for taking the correct RMD amount.

Ed Slott is a professional speaker and the creator of several public television specials, including "Retire Safe & Secure! with Ed Slott." He is the author of *The Retirement Savings Time Bomb...And How to Defuse It* and many other books about IRA planning.

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