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Your Guide to Required Minimum Distributions (RMDs) Part 2: What's Your Withdrawal Strategy?

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In part one of this series, we provided an overall breakdown of what RMDs are, why they came into existence, and how they are implemented. Now, it's time to examine options for best navigating them.

There's no one "right" way to take your RMDs — it's all about what works best for your lifestyle and tax strategy. Some people take their full RMD in January and get it out of the way. Others spread withdrawals monthly or quarterly for consistent income. Some wait until year-end, allowing their money to grow tax-deferred for as long as possible.

We prefer looking at the bigger picture: your cash flow needs, your tax bracket, and your long-term goals. Logistically, we can set up an automatic distribution to transfer cash into your bank account at the appropriate frequency.

AVOIDING AN RMD PENALTY

After the initial RMD is taken by April 1 in the year after reaching RMD age, the annual deadline is then December 31each year for subsequent RMD. Neglecting to take the full RMD amount by the deadline is a costly mistake, as there is a penalty of 25% of the amount not withdrawn. Fortunately, for those who do miss the deadline, SECURE 2.0 now allows the penalty to be reduced to 10%, if corrected in a timely manner. The team at Grimes and Company, as well as your brokerage firm, makes every effort to ensure clients don't face a penalty by planning for and systematizing RMDs whenever possible, and reminding clients of the deadline if a more manual process is in use.

RMD AND IRMAA IMPACT

One issue that often catches retirees off guard is how RMDs can affect Medicare premiums. When income levels go up (say, after a large RMD) it can trigger IRMAA (income-related monthly adjustment amount), a surcharge that increases your Part B and Part D premiums. This is why timing your RMDs and coordinating them with other income sources, such as Social Security or capital gains, is crucial.

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QUALIFIED CHARITABLE DISTRIBUTION (QCD)

Currently the only way to avoid taxation upon distribution of an RMD is known as the Qualified Charitable Distribution (QCD). It requires gifting the cash to a qualified charity, but if charitable gifting is already something that you are doing with net cash flow, this can be a very powerful tax-saving tool. Processing a QCD counts towards your RMD, meaning the money comes out of the retirement account and you fulfill the IRS requirement, but it is not reported as taxable income. For further information, please refer to our QCDs article.

PLANNING AHEAD TO REDUCE RMDS: ROTH CONVERSIONS

Well before an investor reaches RMD age, planning can be done to potentially reduce taxes in retirement. By gradually converting portions of your Traditional IRA to a Roth IRA, you pay the taxes now (ideally while in a lower tax bracket) and reduce the size of your future RMDs, since Roth IRAs aren't subject to RMDs during your lifetime. This can also create more tax-free income later in retirement by building up the Roth IRA (refer to our Roth Conversions article to learn more about this strategy).

RMD planning provides an opportunity to optimize your retirement income, manage future tax exposure, and align your financial plan with your long-term goals. RMDs can also be a way to support causes you care about through charitable giving, or to help transfer wealth to heirs in a thoughtful, tax-efficient manner.

If you're approaching RMD age, managing inherited retirement assets, or wondering how these distributions fit into your broader financial plan, please reach out to us. We are here to help craft a distribution strategy that meets your goals.

IMPORTANT DISCLOSURES:

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