Ways to maximize your minimum required distribution

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If you are age 701/2 or over and own either a traditional IRA, 401(k) plan or other employment-based savings plan, you are usually required to withdraw a certain amount of money each year.

These withdrawals are minimum required distributions (MRD), or what can also be referred to as required minimum distributions (RMD). For consistency purposes, I will refer to them as minimum required distribution (MRD). MRD is usually taxable income, so if you made after-tax contributions to these accounts, part of your minimum required distribution may be nontaxable.

Using your MRD

There are four key elements to consider that help determine how to use your MRD:

1. Do you need the cash for living expenses?
2. Are you planning to make charitable donations at this time?
3. Do you plan to pass assets on to your survivors?
4. Do you plan to reinvest the money?

Cash for living expenses

If you need the income from your MRD for routine living expenses, consider how you manage your cash flow. Retirees often arrange to have payments deposited directly into their bank or taxable brokerage account. Some advantages of this decision are in auto distributions that ensure you meet your MRD requirement by December 31st of each year and avoid an inadvertent shorting of withdrawals, which could cost you a tax penalty.

While on the topic of taxes, it's important to note that you can arrange to have taxes automatically withheld from your MDR account.

When purchasing an annuity, you can turn your IRA or 401(k) assets into a steady stream of income benefits—which are guaranteed for life—and take care of MRDs simultaneously. What makes annuities so attractive? They alleviate the worry that you will outlive your money, but it is important to note that when you select an annuity, you lose access to your principal.

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Having an annuity is done within the context of a comprehensive retirement plan, so only choose an annuity after first discussing how it can affects your overall retirement plan with your advisor. He or she can then make you aware of the two payment options vailable, which are included below:

Fixed payment option – Lifetime payments stay the same, but you can arrange for cost of living increases to keep up with inflation, and access to your principal is limited.

Variable payment option – Over your retirement lifetime, payments vary based on the investments that serve as the substance of your annuity, with specific annuities allowing you to take out larger withdrawals after you buy the annuity.

Charitable donations

If you would like to make a charitable donation in the form of cash, speak with your registered investment advisor about a tactic that involves a Roth IRA conversion and extend your gift-giving while eliminating the need for future minimum required distributions.

Giving to heirs

If you plan on giving to heirs, consult your registered retirement advisor before converting your IRA to a Roth IRA. Compare the tax rate on your converted IRA income (your present rate) to the tax rate your heirs need to pay for inherited assets. If they are already in a lower bracket, your certified retirement planner may recommend you not do it.

A Roth IRA does not have an MRD for the original owner so it grows tax-free, allowing you to leave your heirs a larger sum. But to convert your IRA to a Roth IRA, you must take one MRD from your IRA before converting it to a Roth. Although Roth IRA distributions are not taxable as income, they are subject to estate taxes.

Reinvesting RMDs

If this is what you want to do, consider having the money routed to a non-retirement account so you can invest it based on your timeline, goals, financial condition, and risk tolerance. If you invest your MRD, think of owning tax-efficient assets to potentially cut your tax liability. These include taxfree municipal bonds and municipal bond funds. Be careful though, as income from municipal bonds and mutual funds are subject to the federal alternative minimum tax. If you send the money to a taxable brokerage account, be sure you have thoroughly discussed how those funds are invested with your registered advisor.

This article is just a primer for MRD issues, as they can be quite complicated and are best dealt with by having a detailed discussion with your financial advisor.

This material is intended to provide general financial information and is not written or intended as tax or legal advice. Individuals should seek advice from their own tax or legal counsel for their particular situation. Investment Advisory Services offered through Global Financial Private Capital, LLC, and an SEC Registered Investment Advisor. Jared Elson and Global Financial Private Capital, LLC do not provide tax or legal advice.