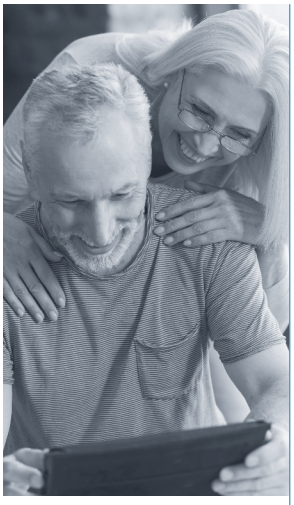
HBKS® Wealth Advisors

Required Minimum Distributions: When Your Retirement Savings Start Paying Off



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Whether you're about to begin enjoying the benefits of your years of saving for retirement or just starting to contribute to a retirement plan, you'll want to know a few things about required minimum distributions (RMDs). Essentially, RMDs are how the federal government recovers at least a portion of the taxes you avoid over the years as you contribute to a tax-deferred plan like a 401(k) or IRA. RMDs officially start at age 70½. That's when you are required to start taking money out of your tax-deferred plan and pay tax on those distributions.

One of the advantages of a tax-deferred plan is that you are likely to be in a lower tax bracket after you retire, so the tax you pay on your RMDs will be less than what you would have paid on those earnings when you were working. Of course, that isn't always the case. When it comes to earnings and taxes, everyone is unique. And while the IRS rules for RMDs generally apply to all taxpayers, they also allow for some creative ways to lessen the impact of — or even eliminate — the tax consequences.

A few basic facts about RMDs:

- You must start taking RMDs as of age 70½, whether or not you continue to work.
- The calendar date you have to start taking RMDs varies. If your birthday is between January and June, you'll start the year of your 70th birthday. If you were born between July and December, you're not required to take your first RMD until the following year.
- Your RMD for each year is calculated by dividing the balance of your tax-deferred savings plan from the prior year by a life expectancy factor. Your savings plan custodian should send you a statement by January 31 letting you know the amount of distribution you will be required to take that year.
- You can take your distributions however you want — monthly, quarterly, etc. — but you have to take the "minimum" by the end of each year.
- If you fail to take your full RMD by December 31 any given year, there is a 50 percent penalty on the shortfall. In some cases, however, the IRS has waived the penalty.

Now, let's look at a couple of situations where the rules encourage some smart tax planning strategies:

- If you are just starting to contribute to a retirement savings account, consider a Roth IRA, or a Roth 401(k) if offered by your employer. Contributions to a Roth are after-tax as opposed to tax-deferred. Because you're paying the tax on that money before its set aside you won't have to pay taxes when you start drawing on it when you retire, nor on any of the dividends, interest and other earnings your Roth has generated over the years. Also, there are currently no RMD requirements for Roth IRAs, so you can leave the money in your Roth to your heirs and it will provide tax-free income or earnings as long as it remains in place. You might even find it advantageous to pay the tax and convert a current tax-deferred plan to a Roth.

- When a taxpayer taking RMDs dies, taxable distributions can be moved into the deceased's estate and the taxes can be deferred, and in some cases, reduced or even eliminated by expenses related to administering the estate.

- If you are past the RMD age but employed by a business that offers a 401(k) plan, and you are not an owner of the company, and you participate in the plan, you do not have to take RMDs from those plan assets.

- If you are required to pay estimated taxes, you can use your RMD at the end of the year to catch up on one or all of your quarterly estimated tax payments without penalty. The withholding from an RMD, even if paid on the last day of the year, is treated as if it has been received equitably throughout the year.

- If you want to contribute to a charity, you can contribute all or part of your RMDs directly to a qualifying charity and avoid having to pay the tax on those distributions. Or you can have the money distributed to a donor-advised fund for future contributions.

RMDs can be substantial depending on how much you have in tax-deferred savings. But there are nuances associated with the laws governing RMDs that provide for options on how you want to take them. Whether you're already retired, approaching retirement or just beginning to save for retirement, talk with your financial advisor about how to maximize your retirement savings in a way that best accommodates your financial circumstances and objectives.

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William F. Casey III is a principal and senior financial advisor in the HBKS® Philadelphia, Pennsylvania, office. His distinguished career includes senior management positions at some of the most respected global financial institutions, including GMAC, Merrill Lynch, Salomon Smith Barney, Union Bank of Switzerland and Mellon Bank.

Bill has a technical background in global banking, asset and liability management and investments, as well as vast administrative experience. He joined HBKS® in 2017 as his firm, Locust Capital Management, merged with HBKS®.

Bill graduated from Lafayette College with a B.A. in economics/finance and from Temple University's Executive MBA program. He is active in his community, volunteering his time as a board member for the Bacharach Hospital Foundation and Carson Valley Children's Aid.

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Michael is a principal in the Blue Bell, Pennsylvania, office of HBK. He has been with the firm since the former Resnick, Amsterdam, Leshner, P.C. merged with HBK CPAs & Consultants in November 2016. He is a Certified Public Accountant (CPA) in the State of Pennsylvania.

Michael started his career as an auditor in the Philadelphia office of Price Waterhouse before making a jump into private industry, where he worked for Global Spill Management, Inc., a publicly-traded company, for six years.

Michael earned his Bachelor of Science degree in business (accounting) from Hartwick College. He has been a Certified QuickBooks Pro Advisor since 1998 and is a member of both the Pennsylvania Institute of Certified Public Accountants (PICPA) and the American Institute of Certified Public Accountants (AICPA).