PLANNING FOR REQUIRED MINIMUM DISTRIBUTIONS WHEN ONE IS STILL WORKING AT AGE-72 AND BEYOND

Nathan Oestreich, Charles W. Lamden School of Accountancy, Fowler College of Business San Diego State University, 5500 Campanile Drive, San Diego, CA 92182, (619) 594-5070, drno@sdsu.edu
James Williamson, Charles W. Lamden School of Accountancy, Fowler College of Business San Diego State University, 5500 Campanile Drive, San Diego, CA 92182, (619) 594-5070, james.williamson@sdsu.edu
Kamal M. Haddad, Department of Finance, Fowler College of Business San Diego State University, 5500 Campanile Drive, San Diego, CA 92182, (619) 594-5311, khaddad@sdsu.edu

ABSTRACT

Reaching the age of brings new challenges for savers. Savers must begin making required minimum distributions, affectionately known as RMDs, in the year that they turn age-72. The first-year distributions can be delayed until the next year, but the person is required to make two years' RMDs in one year. A major exception applies to persons who are still working on the last day of the year and subsequent years. This study investigates how to qualify for this opportunity and how one might plan to maximize the benefit, assuming they do not need the money.

INTRODUCTION

Required minimum distributions, affectionately known as RMDs, are a part of reaching advanced age. These distributions are "required" once a person with qualified defined contribution retirement plans reaches age 72. The distributions for the year when this age is reached are required by April 1 of the following year and the distributions for that following year are required by year-end.

PLANNING FOR RMDs

Planning can be done to accomplish a desirable result, but most importantly, defined contribution owners must be aware of the rules and the hazards related to the failure to take a required distribution. This study, although not an attempt to cover the universe of RMDs, will survey the rules for people who are still working and their opportunities to defer taxes with appropriate planning.

Paying ordinary income tax on RMDs—only required for distributions from traditional retirement accounts, which include Individual Retirement Accounts (IRAs), § 401(k) plans, § 403(b) plans, and simplified employer pensions (SEPs)—can be bad enough. After all, they are on top of one's other income and can affect one's Medicare premium(s). But, failure to make the required RMDs can trigger a 50% penalty.

Research shows that good savers do not take distributions before they are required [Most-retirees]. Apparently, if they do not need the money, they would prefer to defer the tax. About 84% of people reaching the RMD age took the required minimum amounts [1].

Let's say an account holder is still working and can defer the distributions for five years. The benefit varies depending on the individual's marginal tax rate and the discount rate. Using \$100,000 in deferred distributions, a 33 percent marginal tax rate (in all years) and a discount rate of 6 percent, the deferral is worth \$8,340, or 8.34 percent of the amount deferred:

$$\$33{,}000 - \$33{,}000 / 1.06^5$$

Of course, the savings increase if either the marginal tax rate or the discount rate is higher.

The \$100,000 number is the rough approximate amount of RMDs that would be required over 5 years on account(s) totaling \$475,000 (i.e., if the accounts totaled \$475,000 and RMDs were required over 5 years beginning at age 72, the RMDs would be about \$100,000). By continuing to work, and keeping funds in employer sponsored plans, these RMDs can be deferred.

Table 1: RMDs for Various Balances Over an Assumed 5-year Deferral Period (2021).

Opening Balance	Total RMDs for 5-years	age-72	age-73	age-74	age-75	age-76
		25.6	24.7	23.8	22.9	22
\$ 500,000	\$ 105,344	\$ 19,531	\$ 20,243	\$ 21,008	\$ 21,834	\$ 22,727
\$ 750,000	\$ 158,016	\$ 29,297	\$ 30,364	\$ 31,513	\$ 32,751	\$ 34,091
\$ 1,000,000	\$ 210,688	\$ 39,063	\$ 40,486	\$ 42,017	\$ 43,668	\$ 45,455
\$ 475,000	\$ 100,077	\$ 18,555	\$ 19,231	\$ 19,958	\$ 20,742	\$ 21,591

The second row (i.e., 25.6, 24.7, etc.) represents the denominator for determining the portion that must be withdrawn (2021). For example, the first-year requirement for \$1 million is \$1 million / 25.6, or \$39,063 and the five-year total is \$210,688. If these amounts are in employer sponsored plans, the RMDs are not required, so they can be deferred along with any additional earnings.

Note: This five-year time period was selected because it fits the California State University Faculty Early Retirement Program (FERP). Other retirees may have more or less flexibility.

Table 2: RMDs With and Without the "Still Working" Assumption

		Still Working		Not Working	
Factor	Year	RMD	Present Value of RMD After-tax	RMD	Present Value of RMD After-tax
25.6	1	$ -	$ -	$ 18,555	$ 17,504
24.7	2	$ -	$ -	$ 20,403	$ 18,158
23.8	3	$ -	$ -	$ 22,434	$ 18,836
22.9	4	$ -	$ -	$ 24,668	$ 19,539
22.0	5	$ -	$ -	$ 27,124	$ 20,268
21.2	6	$ 36,085	$ 25,438	$ 29,682	$ 20,925
20.3	7	$ 39,675	$ 26,386	$ 32,636	$ 21,705
19.5	8	$ 43,399	$ 27,229	$ 35,699	$ 22,398
18.7	9	$ 47,460	$ 28,091	$ 39,040	$ 23,107
17.9	10	$ 51,888	$ 28,974	$ 42,682	$ 23,833
17.1	11	$ 56,712	$ 29,875	$ 46,650	$ 24,575
16.3	12	$ 61,966	$ 30,795	$ 50,972	$ 25,332
15.5	13	$ 67,683	$ 31,732	$ 55,675	$ 26,102
14.8	14	$ 73,400	$ 32,465	$ 60,377	$ 26,705
14.1	15	$ 79,542	$ 33,190	$ 65,430	$ 27,302
13.4	16	$ 86,131	$ 33,905	$ 70,850	$ 27,890
12.7	17	$ 93,184	$ 34,605	$ 76,651	$ 28,466
12.0	18	$ 100,717	$ 35,285	$ 82,847	$ 29,025
11.4	19	$ 107,785	$ 35,624	$ 88,661	$ 29,304
10.8	20	$ 1,243,834	$ 387,833	$ 1,023,152	$ 319,024
Totals		$ 2,189,461	$ 821,430	$ 1,914,187	$ 769,998
Difference					$ 51,432
Percent of $475,000					10.83%

Assumptions: Growth rate = 10; Discount rate = 6%; Tax rate = 30%

Although simplistic, this model is a first attempt to establish a procedure for measuring the benefit of deferring RMS for those who are still working. The accounts are deemed to be liquidated in Year 20. By the end of 20 years, the present values of the liquidated accounts is $51,432 greater for the "still working" account, which is more than 10 percent greater than the "not still working" account. This model provides some indication of the relative value of utilizing the employer sponsored account for those who are still working, with no degree of precision. Future work will improve the analysis.

Still Working

Whether one is still working is determined based exclusively on employment on the last day of the calendar year. Planning opportunities that are the focus of this paper abound and are covered in the following paragraphs.

Retirees should be sure to check with their account sponsors. It is possible that once one stops working and starts RMDs, that they continue after the individuals starts working again.

Setting Every Community Up for Retirement Enhancement Act of 2019.

Under prior law, RMDs were required for the year in which the plan owner reached age 70 ½ (distributions required by April 1 of the following year) [IRC § 401(a)(9)(C)]. This all changed with the SECURE Act of 2019 [5]**.** For 2020, no RMDs were required and beginning in 2021, RMDs are required beginning in the year an individual reaches age 72. The distribution for the year that the person reaches age 72 can be delayed as late as April 1 of the following year [IRC § 401(a)(9)(I)].

> Example: Alice reached the young age of 72 in 2022, having accumulated employer sponsored traditional defined contribution retirement accounts (e.g., § 401(k)) worth $1 million on January 1, 2022. Alice's RMDs from the account are zero as long as she is still working. If the accounts were not related to her employment, even if Alice is still working, RMDs of $39,063 in 2022, $40,486 in 2023, $42,017 in 2024, $43,668 in 2025 and $45,455 in 2026, assuming the account retains its value of $1 million (e.g., earnings equal withdrawals). The 2021 contribution could be made by April 1, 2020, but the 2022 contribution is also due in 2022, by year end.

EMPLOYER AND NON-EMPLOYER PLANS

As noted above, seniors are not required to take RMDs from employer plans if they are still employed on the last day of the year. This affects one's selection of a retirement date since employment status on December 31 controls for the entire year.

Certainly, this provides and incentive to continue working for many individuals. Even part-time employment may be sufficient.

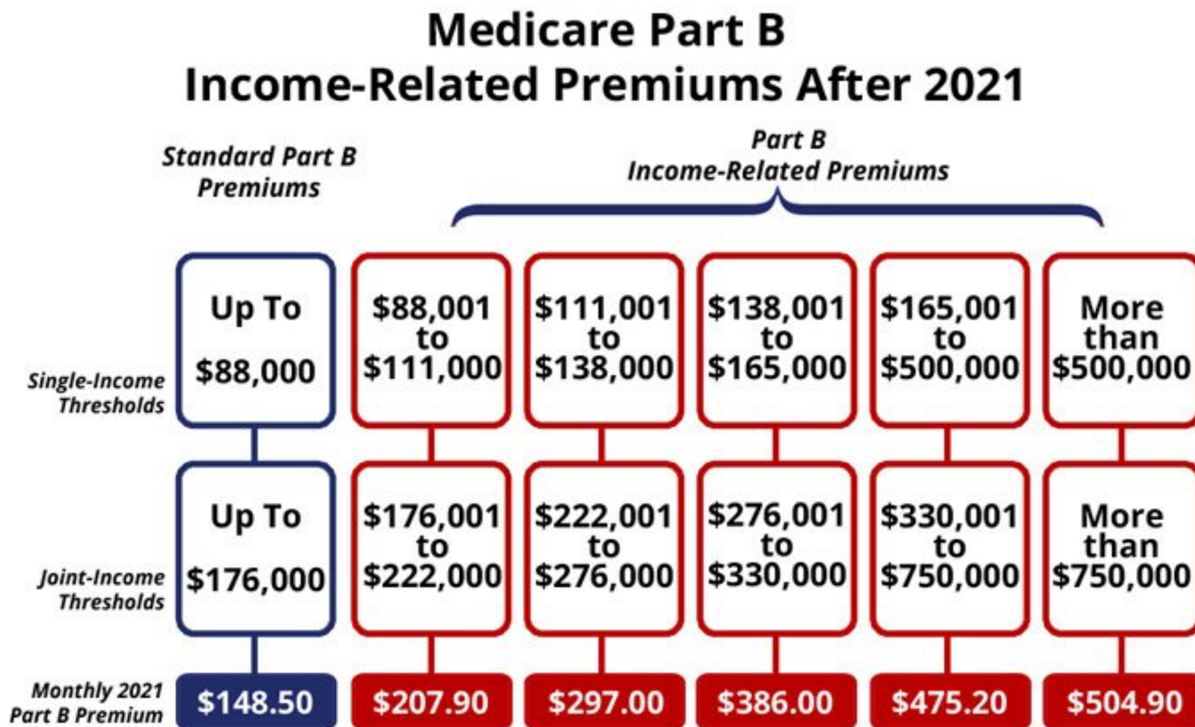
Many will have other, non-employer accounts. They can roll these other accounts into the employer plans, assuming the employer plan will accept the rollovers [4]. One must consider early withdrawal penalties that may be triggered upon the rollover.

> Example: Felix, who turned 72 in 2022, has $500,000 in employer related defined contribution retirement accounts and $500,000 in other retirement accounts. If Felix is still working, there are no RMDs required for the employer related accounts, but RMDs of $19,531 in 2022, $20,243 in 2023, $21,008 in 2024, $21,834 in 2025 and $22,737 in 2026, are required. If the sponsor of the employer related plans will accept rollovers from the other plans, Felix can execute rollover before January 2022, thereby eliminating all RMDs.

RELEVANT SIDE ISSUES

Medicare Part B Premiums.

Avoiding RMDs may allow one to avoid increased Medicare Part B premiums. Medicare Part B premiums are based on modified adjusted gross income, which is adjusted gross income plus excludable municipal bond interest, for the second prior tax year. Large RMDs, or elective retirement account withdrawals, could result in an increase in the premiums [2] [3].



Source: Centers for Medicare & Medicaid Services

Note: The 2022 base premium increased to $170.10, with similar increases to the others.

> Example: Raymond, single and age-72, is expecting to have modified AGI of $112,000 in 2021, including RMDs of $25,000. If Raymond can avoid the RMDs if the distributions are from employer related accounts, Raymond's modified AGI would be $87,000. This would result in Raymond's Part B premium being reduced from $297 to $148.50 per month (in 2023, due to the fact that premiums are based on modified AGI from the second prior year). These amounts need to be adjusted for the inflationary changes.

Qualified Charitable Distributions

For those who want to include charities in their retirement plans, qualified charitable distributions (QCDs) can only be made from individual retirement arrangements (IRAs). These count toward RMDs. This may

incentivize one to maintain some IRAs, or even move some balances into an IRA from an employer plan or non-employer plan.

> Example: Simone, who turned 72 in 2022, has significant amounts in employer related defined contribution retirement accounts and $100,000 in traditional IRAs. If Felix is still working, there are no RMDs required for the employer related accounts, but RMDs of $3,906 in 2022, $4,049 in 2023, $4,202 in 2024, $4,367 in 2025 and $4,446 in 2026, are required. If Simone wishes to benefit charities, Simone can make QCDs which will, if adequate in amount, satisfy the RMD requirement. This is exceptionally valuable for most seniors since few of them itemize their deductions after 2017. Further, if Simone exhausts her IRAs, she should consider rolling part of her employer related accounts into the IRA for subsequent contributions.

CONCLUSION

Planning opportunities abound for those reaching advanced age and having traditional retirement accounts. Decisions as to when to whether to use traditional accounts rather than Roth accounts, rather to quit working, and rolling funds into employer sponsored plans are just a few. These considerations make good fodder for a conference session.

REFERENCES

[1] CNBC, August 25, 2021 [https://www.cnbc.com/2021/08/25/most-retirees-arent-tapping-nest-eggs-before-required-withdrawals.html].
[2] Centers for Medicare and Medicaid Services.
[3] Internal Revenue Code § 401(a)(9)(C)].
[4] Retirement Living [https://www.retirementliving.com/all-about-required-minimum-distributions]
[5] *Setting Every Community Up for Retirement Enhancement of 2019,* PUBLIC LAW 116–94—DEC. 20, 2019.