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UNDERSTANDING REQUIRED MINIMUM DISTRIBUTIONS



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UNDERSTANDING REQUIRED MINIMUM DISTRIBUTIONS

The idea behind Required Minimum Distributions, or RMDs, is that the government wants to give us a tax incentive to save for retirement – but they also want to make sure we don't misuse it. So, if we're in the 24% tax bracket and we put money into a tax-deductible IRA or a 401(k), each dollar we put in really only costs us 76 cents because it's a before-tax contribution. So, the government is helping us save, but the government really wants this to be retirement money. In other words, they don't want it to be money that you never spend or leave for your heirs. They want to make sure you pay tax on it eventually.

IRAs are one example of a use-specific plan, which the government loves. The 529 College Tuition Plan is another example; it's extremely tax-efficient for the investor if used for college, but extremely tax-inefficient if used for retirement. Similarly, IRAs are designed to encourage people to save money for retirement, and if the money is used for that purpose, then it's taxed in a friendly manner. If it's used for anything else, it's not.

The challenge for the IRS in providing this incentive for retirement savings has been the same challenge faced by the Social Security Administration in maintaining the system's solvency: people are living longer. Today, there is a 50% chance that the average 65-year-old American will live into their late 80s. For the average couple aged 65, there is a 50% chance that at least one spouse will live to age 92. The IRS doesn't want to wait until your death to get its tax money because it might end up waiting a very long time. Thus, everyone is required to begin taking minimum distributions from their savings plans after age 72.

To the government's credit, it has actually lowered RMD percentage amounts in recent years because it recognized that increasing longevity rates were creating challenges from the other end as well, with some people legitimately worried about depleting their IRAs before they died. The bottom line is simply that the IRS doesn't want retirement income vehicles to be used as inheritance vehicles, so they require you to take minimum amounts of income from those vehicles each year once you've reached the requirement age.

When Do I Take RMDs?

Again, the general rule is that you have to start taking RMDs in the year you turn 72.

The one exception to all of this is for someone still employed at age 72 at a business that they do not own. In that case, you do not have to take Required Minimum Distributions on that particular retirement plan. You still must take them on any other retirement plans, such as your IRA, but not on the plan that's with a company for which you are still employed at age 72.

How Much Do I Owe?

The penalty for not taking sufficient RMDs each year after age 72 is significant — 50 percent — so it's important to do your calculations correctly. The good news is that, in addition to reducing RMD amounts in recent years, the government has also made it easier to calculate what you owe. Here is basically how it works:

- IRS Publication 590 gives you a uniform table with a government-assumed life expectancy for each age past 70. Note that your government-assumed life expectancy is actually much longer than your statistical life expectancy:

Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
70	27.4	82	17.1	94	9.1	106	4.2
71	26.5	83	16.3	95	8.6	107	3.9
72	25.6	84	15.5	96	8.1	108	3.7
73	24.7	85	14.8	97	7.6	109	3.4
74	23.8	86	14.1	98	7.1	110	3.1
75	22.9	87	13.4	99	6.7	111	2.9
76	22.0	88	12.7	100	6.3	112	2.6
77	21.2	89	12.0	101	5.9	113	2.4
78	20.3	90	11.4	102	5.5	114	2.1
79	19.5	91	10.8	103	5.2	115 and over	1.9
80	18.7	92	10.2	104	4.9		
81	17.9	93	9.6	105	4.5		

Source: https://www.irs.gov/pub/irs-tege/uniform_rmd_wksht.pdf

- To calculate your RMDs, take the balance of your IRAs on December 31st of the previous year and divide it by this life expectancy factor.

- At age 72, that RMD equals approximately 3.7% of your IRA balance and increases every year as you get older.

While this process is simpler than it used to be, it's not totally easy. The uniform table formula above applies to unmarried IRA owners and owners whose spouses are not more than 10 years younger. A separate formula and a separate table exist for IRA owners whose spouses are more than 10 years younger, and generally their RMDs end up being lower.

There are other complications as well. For instance, certain kinds of annuities have to be separated from the basic calculation, and those RMDs must be calculated differently. Specifically, these are annuities that are annuitized or have to be annuitized at some point in the future. These particular instruments increase the dollar amount of your RMDs and therefore also increase the amount of taxes due on them.

Another complication is that when one has IRAs but also any form of qualified plan — such as a 401(k), 403(b), or 457 — the RMDs from the IRA and each of these plans must be calculated and made separately; they cannot be commingled. This is one of the major reasons (though not the only one) that most people roll over their qualified plans into IRAs before age 72; it makes life simpler.

What About Taxes?

The amount of extra tax liability you have because of your RMDs depends on many factors, including your personal situation and how much income you have from other sources. The key is to understand the concept of a marginal tax bracket, which is based upon an average of all the tax brackets that you're currently in. For example, if your marginal tax bracket according to your tax preparer is currently 17.3%, it's because you have 1) maximized your 10% bracket, 2) maximized your 15% bracket, and 3) had some income in the 24% bracket. The blended rate is an average of 17.3%. However, once Required Minimum Distributions get stacked on top of your other income sources, your marginal tax bracket will be 25% and the RMDs will be taxed accordingly. Income tax brackets for RMDs are: 10%, 12%, 23%, 24%, 32%, 35%, and 37%:

Federal tax brackets: 2019 tax brackets (for taxes due April 15, 2020)		
Tax Rate	Single	Head of Household
10%	Up to \$9,700	Up to \$13,850
12%	\$9,701 to \$39,475	\$13,851 to \$52,850
22%	\$39,476 to \$84,200	\$52,851 to \$84,200
24%	\$84,201 to \$160,725	\$84,201 to \$160,700
32%	\$160,726 to \$204,100	\$160,701 to \$204,100
35%	\$204,101 to \$510,300	\$204,101 to \$510,300
37%	\$510,301 or more	\$510,301 or more
Tax Rate	Married filing jointly or qualifying widow	Married filing separately
10%	Up to \$19,400	Up to \$9,700
12%	\$19,401 to \$78,950	\$9,701 to \$39,475
22%	\$78,951 to \$168,400	\$39,476 to \$84,200
24%	\$168,401 to \$321,450	\$84,201 to \$160,725
32%	\$321,451 to \$408,200	\$160,726 to \$204,100
35%	\$408,201 to \$612,350	\$204,101 to \$306,175
37%	\$612,351 or more	\$306,176 or more

Source: <https://www.bankrate.com/finance/taxes/tax-brackets.aspx>

However, even with all this information, there are still other factors to consider when it comes to RMDs. One of them is Social Security. Every extra dollar of taxable income generated from any source, including RMDs, might cause a greater part of your Social Security benefit to be taxed.

This is where your RMD calculation gets very challenging because it can potentially become a perpetual loop calculation that might change every year depending on your personal situation:

Tax Filing Status	Provisional Income	Social Security Taxation
Single or Head of Household	Less than \$25,000	0%
	\$25,000-\$34,000	Up to 50%
	More than \$34,000	Up to 85%
Joint Filers	Less than \$32,000	0%
	\$32,000-\$44,000	Up to 50%
	More than \$44,000	Up to 85%

Source: <https://www.foxbusiness.com/markets/2016/01/11/how-to-calculate-provisional-income.html>

Don't Try This at Home

Whatever that situation may be, the most important thing for you to consider regarding RMDs (as well as Social Security) is whether or not your asset allocation is suitable and sufficient to generate the amount of minimum distributions you need to satisfy your requirements. It should be generating at least 3.7% dividend or interest. If you're relying on capital gains each year for your RMDs, then, in essence, you're taking them from principal, which is a slippery slope that you definitely want to avoid.

While it is smart and advisable to use IRS Publication 590 and other available information and resources to estimate your RMDs, the process of creating a sound, retirement plan that suits your needs and meets your goals is best done in collaboration with a qualified professional financial advisor. In today's economic climate, an advisor who specializes in the universe of non-stock market income-generating investments is uniquely qualified to work with you to devise a plan that satisfies your RMDs, maximizes your Social Security benefits, and provides the kind of reliable income, reasonable growth, and level of portfolio security you need to meet your goals with confidence and peace of mind.

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5 Things that Set Our Income Specialists Apart

In the financial services industry, financial advisors will typically specialize in either the stock market or the bond market, but seldom both. If an advisor says they can help you with fixed income investing, most will take the easy way out and invest your money in bond mutual funds.

The problem is that bond funds tend to have risks and tax implications that can be significantly reduced by investing in an actively managed portfolio of individual bonds. That brings us to the first thing that sets the Income Specialists at Sound Income Strategies and The Retirement Income Store® apart from the typical stock market-based financial advisor.

1. Income Specialists Invest Client Money in Individual Bonds, Not Bond Mutual Funds

Our Income Specialists possess the specialized training and knowledge required to create customized portfolios of individual fixed income securities, such as bonds and bond-like instruments. When you buy an individual bond, you have a guarantee that you'll get a fixed rate of interest for the life of the bond, and when the bond matures, you're guaranteed to get the face value of the bond back at maturity—assuming no defaults. With bond mutual funds, neither guarantee exists.

2. Income Specialists Look Beyond the Ratings

We learned during the Financial Crisis of 2007-2009 that all those AAA-rated mortgage bonds that were about to default had ratings attached to them that were far too generous. Income Specialists know they need to look beyond these ratings to research the actual financials and management of the issuers themselves.

3. Income Specialists Use Limit Orders

Most advisors will purchase fixed income securities using market orders and will end up buying those securities at prevailing market prices for that day. Our Income Specialists use limit orders when buying fixed income securities on their clients' behalf. That way, if the prices of those securities happen to be up that day, we can be sure our clients don't overpay.

4. Income Specialists Go Directly to Buyers And Sellers to Negotiate The Best Prices

Our Income Specialists are committed to conducting the research required to find out who is buying and selling various fixed income securities at any given time. That way, our traders can go directly to the buyer or seller and negotiate a better price for our clients.

5. Income Specialists take an Active Management Approach

Our active management of individual fixed income securities allows our portfolio managers to continually identify and act upon opportunities to maximize returns for our clients. Our active management approach allows us to take advantage of market dislocations and other short-term developments in order to capitalize on opportunities to upgrade, or swap, for higher yields or capital gains for our clients.

While most Registered Investment Advisory firms take shortcuts to simplify their efforts, our management team is diligent in their research. We seek to build customized portfolios of individual fixed income securities that fit the individual needs of each client. In other words, we concentrate on helping you look forward to retirement with a greater sense of security than most typical stock market-based plans can offer.

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5 THINGS THAT SET US APART

