THE NEWS TRIBUNE

Here are strategies for investing your required IRA withdrawals if you don't need cash

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Two rounds of the SECURE Act have revised the ages at which individuals are required to begin making annual minimum withdrawals from IRAs, 401(k), 403(b) and other tax-deferred retirement accounts.

Most people in their 70s take these withdrawals, and sometimes more than the minimum, to cover their living expenses for the year. However, there are some people who don't need withdrawals from investment accounts to make ends meet. This most typically applies to people who have pension income in addition to Social Security and primarily use their investment assets only for discretionary spending, often episodically.

For people who are required to remove money from their pre-tax accounts – so that the IRS can participate in these accounts by taxing the withdrawals as ordinary income – but don't need to use those withdrawals, there are a few ways to keep this money working toward financial goals.

TAKE AN IN-KIND' DISTRIBUTION, NOT CASH

If you prefer to keep your money invested, you could simply move shares of an investment out of the IRA to a taxable brokerage account to satisfy the required minimum distribution (RMD).

You could instruct the custodian of your accounts (usually by submitting an IRA distribution form) to move the desired amount from the IRA to your taxable account. If your RMD is $20,000 and you own $50,000 of ABC stock or XYZ mutual fund, you provide instructions to move the necessary number of shares to satisfy the $20,000 distribution. This doesn't work from an employer retirement plan since they typically distribute only cash. That is one benefit of rolling over your employer plan money to an IRA.

Even though the position isn't liquidated, you would owe ordinary income tax on the amount of money moved. Therefore, you would need to have enough money set aside in cash to pay the tax due (possibly as part of quarterly estimated tax payments or when you file your return the following year). When you move shares to a taxable account, the value of the shares on the date of transfer becomes the cost basis within the taxable account. The holding is shifted from an ordinary-income asset to a capital-gain asset.

The most tax-efficient way to do this is to transfer holdings that do not pay income (e.g., non-dividend paying, growth-oriented stocks or exchange-traded funds). That way, the investment defers taxation, not incurring any tax until it is sold, or possibly even receiving a step up in cost basis at death, resetting the amount of taxable gain for your heirs.

MAKE A QUALIFIED CHARITABLE DISTRIBUTION

If charitable giving is important to you, making a payment directly from your IRA to a qualified non-profit organization could reduce your tax bill. You could donate up to $100,000 of your RMD directly to a qualified charity annually. You won't owe any ordinary income tax on the amount donated. The charitable organization receives the full amount of the untaxed gift.

This path is more beneficial tax-wise than receiving the IRA distribution, having it added to your taxable gross income for the year and then turning around and gifting after-tax dollars.

By using the qualified charitable distribution, you would reduce your adjusted gross income, which could also help reduce your Medicare premiums. That is a good way to make donations if you use the standard deduction on your tax return and wouldn't be itemizing charitable deductions.

CONVERT TO A ROTH IRA

There is currently no income limit or earned income requirement that restricts people from converting money (or investments) in tax-deferred retirement accounts to a Roth IRA. While pre-tax Traditional IRAs and Rollover IRAs require annual minimum distributions, Roth IRAs do not. This strategy does not eliminate your current-year RMD, but lowering the balance of your IRA via the Roth conversion would reduce your future required distributions from the pre-tax account.

Future growth in a Roth IRA is tax-free, even for your heirs. If you don't expect to need some of your investment savings for your own retirement income, converting to a Roth IRA might be particularly beneficial to the next generation, especially if they have a higher effective tax rate than you.

To perform a conversion, it is necessary to pay ordinary income tax on the amount converted. (It could be any amount. It does not have to be all of an account.) Accelerating taxation is tough to swallow for many people. But in the right circumstances, the long-run tax benefits could outweigh the upfront tax costs. Some people are serial converters, filling up their current tax bracket each year but not converting so much that the move shifts them into a higher tax bracket.

This process is another reason why it's helpful to move 401(k) or other employer plan assets into a rollover IRA, allowing better tax planning.

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