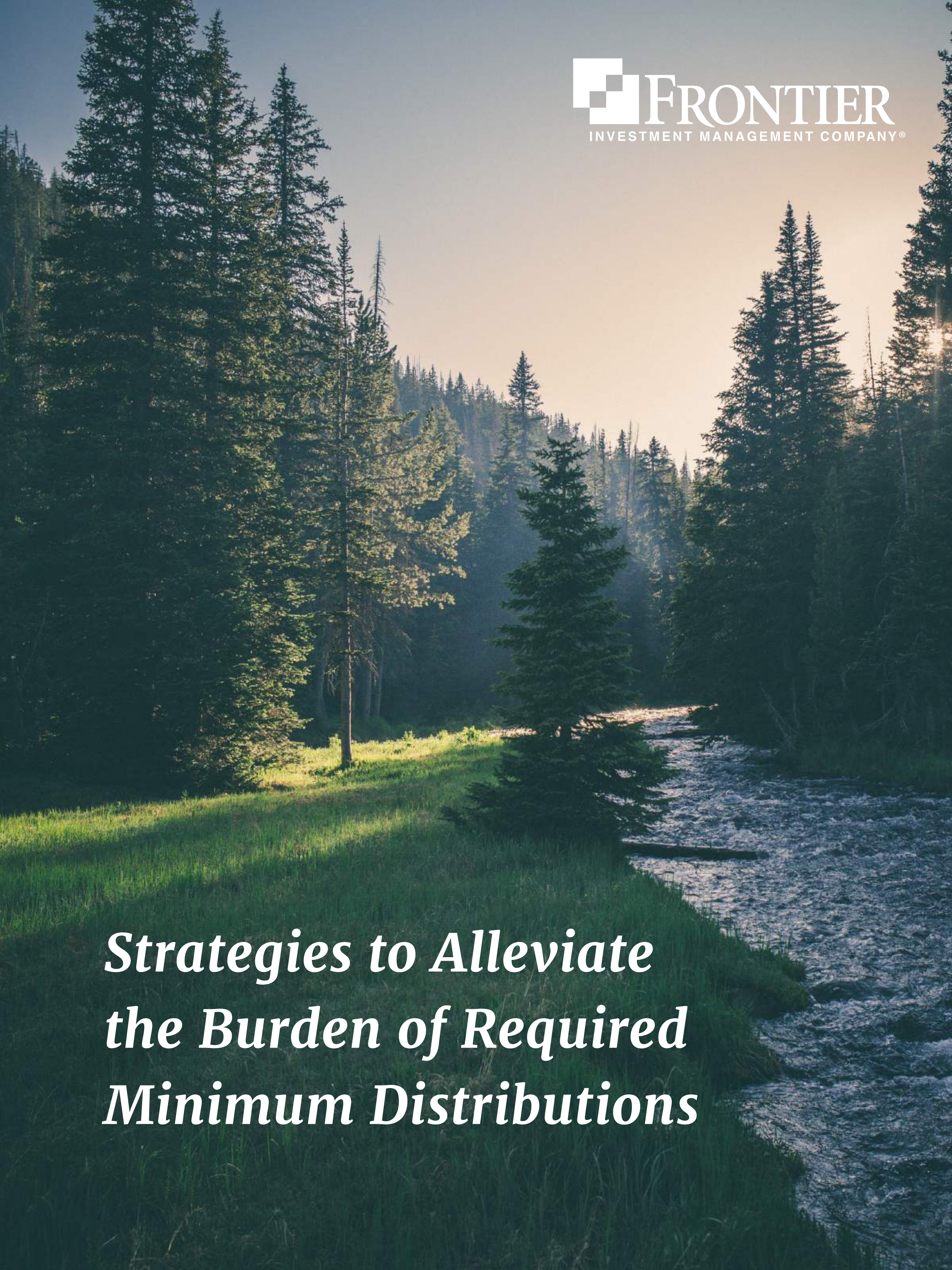

FRONTIER
INVESTMENT MANAGEMENT COMPANY®

Strategies to Alleviate the Burden of Required Minimum Distributions

Strategies to alleviate the burden of Required Minimum Distributions (RMDs)

By contributing to an IRA, taxpayers likely enjoyed a tax deduction in exchange for the promise to "repay" taxes on future withdrawals. If an individual had *absolute* control over the timing of IRA distributions, they would have more flexibility in managing their effective tax rate in retirement. Unfortunately, IRA account holders don't have complete control over distributions. The IRS mandates minimum withdrawals from IRAs (and most tax-deferred retirement accounts) once the owner reaches age 70.5. These are known as Required Minimum Distributions, or RMDs for short.

One problem with these forced distributions is that the funds must be withdrawn (and taxes paid) regardless if the money is needed for living expenses. If ALL a retiree's accounts are tax-deferred then withdrawals could be taxed at a high rate - - possibility a higher rate than the original contribution (deduction). Further, the burden of an RMD is not lifted when these types of accounts are left to heirs.

Understand your mix of retirement assets

Determine your retirement account ratio between the tax-deferred, tax-free, and after-tax environments. If most of your savings is concentrated in the tax-deferred environment, then you may have large RMDs down the road. Below are three strategies to reduce current/future RMDs for those already age 70.5 or younger.

1. Roth IRA conversions

Roth IRAs are not currently subject to RMDs in the primary owner's lifetime. Distributions from these accounts are generally tax-free for both the account owner *and their heirs*. Currently, there is no adjusted gross income or age limitation on converting a traditional IRA to a Roth IRA. Therefore, you could convert a portion or all your IRA to Roth before and during RMD phase. The conversion must be done efficiently by working with your tax advisor (see marginal tax rate discussion in #2). **If over age 70.5,** be careful to record your current RMD first before converting any portion of the IRA to Roth. This strategy is especially valuable if current cash flow is not needed to cover living expenses.

2. Take systematic IRA distributions early before age 70.5

The amount of an RMD is normally calculated by using the balance of the IRA at Dec. 31st of the preceding year. Having less in the account before year-end would reduce next year's RMD. Consider taking tax-efficient systematic IRA distributions each year after age 59.5 or in early years of retirement. Work hand in hand with your tax advisor so that you don't end paying too much taxes. A tax advisor should be able to calculate the approximate size of a distribution to stay within a marginal tax rate or one bracket higher. Not only would this reduce future RMDs but starting IRA distributions early could allow you to delay collecting social security income closer to age 70. Delaying these benefits would allow you to receive the maximum benefit (8% increase per year).

3. Qualified Charitable Distributions (QCD)

This strategy is only available to those ages <u>70.5 or older.</u> If charitably inclined, a taxpayer often makes donations to a charity and itemizes the contribution on their tax return. A powerful exception (now permanent) in the tax code allows an IRA owner to send IRA funds directly to a 501(c)(3) charity (donor advised funds, private foundations, and supporting organizations do not qualify) instead of receiving the funds personally. The charitable distribution (up to $100K per IRA account owner) would not be included in taxable income AND would satisfy the current year RMD requirement. In most cases, this yields a greater tax benefit than itemizing the deduction. **Be sure to alert your tax preparer of a QCD** because the 1099-R will show the total distribution as taxable. The tax preparer will need to enter the non-taxable amount and "QCD" on the tax return.

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