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Americans' Required Retirement Income Has Never Been Higher

Fidelity expects IRA distributions for clients to reach $25 billion in 2024, which could have major ramifications

By Anne Tergesen
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The higher required minimum distributions will push some retirees into higher tax brackets. PHOTO: AL DRAGO BLOOMBERG NEWS

A surging stock market pushed many retirement account balances to new highs in the waning days of 2023. But for those already spending their retirement nest eggs, these higher balances are a mixed blessing.

The reason has to do with rules that require older people to start taking money out of their traditional pretax 401(k) and individual retirement accounts each year, called required minimum distributions or RMDs. The amount is calculated by taking an individual's account balance on Dec. 31 and dividing it by their life expectancy.

Fidelity Investments, which administers IRAs for millions of Americans, expects cumulative RMDs for clients to reach a record high of $25 billion in 2024. In part, that reflects stock indexes such as the Dow Jones Industrial Average hitting record high levels at the end of 2023.

A rising balance at year-end 2023 means the amount of money many retirees have to take out of retirement accounts in 2024 will increase. And along with it, the amount of money they owe in taxes will also rise.

Although tax brackets are adjusted for inflation, the market's strong performance in 2023 means the higher RMDs will push some retirees into higher tax brackets. It will also require some to pay surcharges on future Medicare premiums, which are based on income. For others, the increases will trigger a 3.8% surtax on net investment income, which kicks in when modified adjusted gross income exceeds $200,000 for single people and $250,000 for married couples, thresholds that aren't adjusted for inflation.

Also inflating RMDs is Congress, which recently raised the age at which people are required to start withdrawing money from tax-deferred retirement accounts to 73 on Jan. 1, 2023 from 72 and 70½ before that.

That gives investors who can afford to leave their retirement savings untouched the opportunity to let the money grow tax-deferred for longer.

The downside is that when RMDs start, they tend to be bigger, said Jeffrey Levine, chief planning officer at Buckingham Wealth Partners. That's because a 73-year-old has a shorter life expectancy than a 72-year-old and so must withdraw a larger percentage of a balance that's appreciated for longer, he said.

Here are strategies tax and financial advisers recommend to lessen the impact of higher RMDs.

Qualified charitable distributions

Kevin Lynch, 73 years old, is retiring this week from his job as a college professor. He and his wife plan to pay their essential expenses with their Social Security benefits and annuity income.

To avoid taxes on their $10,200 RMD for 2024, the Stedman, N.C., couple recently instructed their retirement account custodian to donate their entire RMD amount from their traditional IRA directly to 11 charities using a strategy known as a qualified charitable distribution, or QCD.

A QCD can count toward an RMD, up to a limit this year of $105,000.

While the Lynches won't be able to take itemized deductions for their charitable donations, their QCD isn't taxable. That means their required distribution won't inflate their adjusted gross income, or AGI, which is used to determine Medicare surcharges, the 3.8% surtax on net investment income and some tax deductions, among other things.

Since QCDs are available to people 70½ or older, they can be used before RMDs begin to reduce traditional IRA balances, said Levine.

QCDs must go to 501(c)(3) charities and are off-limits for transfers to donor-advised funds. The money must be transferred directly from the IRA to the charity, so the owner can't take a distribution and decide to send a donation later.

RMD exemptions

Like Lynch, more people are working later in life.

Those still employed are generally exempt from RMDs in their current employer's retirement plan. Lynch, who turned 73 last year, is taking RMDs from his IRAs, but has avoided tapping his current employer's retirement plan.

You may be able to roll over certain IRAs and 401(k)s from previous employers into a current employer's plan, if the plan permits it. That would allow you to avoid taking required distributions on those balances as well, said Lawrence Pon, an adviser in Redwood City, Calif.

Still, there's a limit to what funds can be combined. Retirees can't mix their own retirement money with inherited retirement funds from a deceased relative or friend.

For those with inherited retirement accounts, it's worth noting a recent law effectively raised RMDs on many accounts. Many beneficiaries must now drain those accounts within a decade and pay any taxes due, rather than take RMDs over their own lifetimes.

Roth conversions

To shrink the size of his traditional retirement account balances, Lynch converted some of his savings to a Roth account in 2021 and 2022, paying income tax on the conversions with money from his taxable brokerage account.

The strategy often makes sense for people in early years of retirement who find themselves in a temporarily lower tax bracket or who expect to be in the same tax bracket in their later years, said Levine.

The conversions have helped Lynch cut his RMDs from nearly $15,000 in 2021 to $10,200 today.

He currently has close to 70% of his $1.3 million in retirement savings in a Roth IRA, where the money can grow and be withdrawn tax-free. Roth accounts are exempt from RMDs, although those who inherit them from someone other than a spouse must generally drain them within a decade.

In years in which pulling more money from a traditional IRA would push the Lynches into a higher bracket, they can instead supplement their income with tax-free Roth withdrawals.

Lynch's adviser, **Brad Pistole,** said with the tax cuts Congress enacted in 2017 scheduled to expire at the end of 2025, it might make sense for retirees to consider taking more than the minimum required from their retirement accounts to fill up lower tax brackets while they're still here.

While RMDs cannot be converted, additional withdrawals can be.

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