Reduced RMDs Beginning in 2021

Last week, the IRS proposed updates to the life expectancy tables used to calculate Required Minimum Distributions (RMDs). The new changes still need to go through a formal approval process and are not scheduled to be implemented until the 2021 tax year. However, the changes are not controversial and are expected to be approved.

Reflecting Increased Life Expectancies

This will be the first time the IRA distribution tables have been updated since 2002, despite the fact that since then, life expectancy has increased more than 2% (or 1.6 years) for all Americans, and more than 8% for Americans who have reached the age of 65! The average life expectancy for a 65-year-old in 2002 was an additional 17.9 years. That had grown to 19.4 years by 2017. Interestingly, although life expectancy has increased since 2002, it has leveled off and actually declined slightly over the past few years.

How Much Are RMDs Reduced?

The lower RMDs will allow owners of IRAs, and other qualified retirement accounts, to keep a bit more of their money growing tax-deferred. The changes are not dramatic. For example, the percentage that an IRA account holder would need to withdraw at age 71 will drop from 3.78% of the account value to 3.55%. A 71-year-old IRA account owner with a $1 million IRA would be required to take $2,300 less based on the new Uniform Lifetime Table. This is good news for IRA owners who do not need the income and would like to keep their money invested in a tax-deferred account. However, only about

20% of IRA owners take the minimum required each year, according to the IRS. Some investment providers dispute this statistic. Nevertheless, the large segment of the population that takes more than the minimum required from their IRA each year will see no impact / benefit from the new tables.

Reduction in RMD Varies by Age

The differential between the RMD based on the current Uniform Lifetime Table and the proposed one is not static. It varies by age. The biggest difference occurs at age 84, when RMDs will be 7.74% lower under the new table. (View: Current vs. Proposed Uniform Lifetime Table, and differential by age). The differential declines after age 84, and the required distribution is equal by age 101. The RMD for an 84-year-old IRA account holder with a $1 million balance would have been $64,600 under the current table, but it drops to $59,600 under the proposed table. The RMD is $5,000 less in this example, and the tax savings would depend on the taxpayer's marginal tax-bracket. A taxpayer in the 24% marginal tax bracket would pay $1,200 less ($5,000 x 24%).

All Three Tables Will Be Affected

The proposed changes will also affect the Single Life table (used to calculate RMDs from inherited IRAs) and the Joint Lifetime Table (used for married couples when the spouse is more than 10 years younger than the IRA account owner).

Final Thought

Lower RMDs will not make a major difference in the average American's financial plan. The largest benefit will accrue to wealthier households that are in higher tax brackets and can afford to take only the minimum required from their qualified accounts. The additional tax-deferral benefits can be meaningful for households that have large IRAs and only take the minimum RMD each year for 20+ years. Regardless of magnitude, any tax-savings is welcomed, and this update was overdue.

Have a great weekend

- Jeremy Kisner
  Director of Financial Planning and Senior Wealth Advisor