# When's the Right Time to Take RMDs?

Where you go for required minimum distributions will usually have a bigger impact than when you go.

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For affluent retirees, "right time" and "RMDs" don't belong together in the same sentence.

If you're past age 72, those withdrawals have to start coming out of your tax-sheltered retirement accountsâ€"traditional IRAs and 401(k)s, as well as Roth 401(k)sâ€"in the year following the year in which you attain age 72. If you don't take them on scheduleâ€"by April 1 of the year following the year you turn 72 and by year-end of each year thereafterâ€"you'll face a penalty of 50% of the amount you should have taken and didn't. Plus, you'll still owe ordinary income taxes on the money, as you would with any IRA distribution.

The RMD age recently moved to age 72 from 70.5, and the new tables for RMD calculations require slightly smaller percentage withdrawals than in the past, to reflect gains in life expectancy. But for retirees who don't need to tap their IRAs for cash at the same level than the RMD tables require them to do, RMDs represent a loss of controlâ€"and a potentially higher tax bill. After all, those distributions are taxable, to the extent that they consist of money that you've never paid tax on. They have the potential to shove you into a higher tax bracket, increase your Medicare premiums and Social Security-related taxes, and disqualify you from tax credits and deductions.

As noted above, the RMD rules don't give retirees a lot of room to roam. But how about the timing of RMDs in a given year? Are you better off taking your distribution at the beginning of the year or at the end? Or should you take them throughout the year, the better to fund living expenses and cover quarterly estimated taxes?

## How RMDs Are Calculated

Before we go any further, let's discuss how RMDs are calculated. The amount you must take out is based on your balance at year-end of the previous year divided by what's called a *life expectancy factor*. If your

IRA balance was $800,000 at the end of 2021, for example, but dropped to $650,000 by the end of 2022, you'll still calculate your RMD amount that you'd withdraw in 2022 using the $800,000 number. Your RMD in 2023 would reflect 2022's market declinesâ€"there's just a lag effect.

It's also worth noting that you arrive at your RMD by calculating the amount for each of your accounts, but you can add all of those RMDs for like accounts. For example, if you have multiple traditional IRAs, you can take the whole RMD from a single account or even a single holding as long as you take the right amount. Such strategic RMD-taking is a way to improve your portfolio on an ongoing basis.

## Now, Later, or in Between?

Here are the three timing approaches that RMD-subject retirees could consider, along with the pros and cons of each.

### Option 1: Wait Until Year End

*Why consider it:* RMD-subject retirees have until Dec. 31 to take their distributions. You shouldn't cut it that close, but there's a case to be made for waiting until early or mid-December, at least. Just as IRA contributors would do well to make their contributions as early in the year as possible, the better to take advantage of tax-deferred compounding over their lifetimes, RMD-subject investors can enjoy extra tax-deferred compounding benefits by delaying their withdrawals.

Let's use a simple, single-year example to illustrate how waiting can pay off. Assume 75-year-old Anne's IRA totaled $1 million at the end of 2021, making her RMD $40,650 for 2022. If she took out and spent her RMD at the beginning of 2022 and the money remaining in her account subsequently earned 12% for the year, she'd have $1,074,472 in the IRA at year-end 2022. If, on the other hand, she delayed the RMD until year-end 2022, and her full $1 million was earning 12% for 2022, her IRA would be worth $1,079,350 at year-end, after the $40,650 distribution, meaning more money in place for the year ahead. (The above illustration doesn't take into account any taxes she'll owe on her RMDs, but since the RMD amount is the same, and the tax year is the same, RMD-related taxes won't affect the general finding.)

That's the story of any money that is invested for tomorrow (and gains in value) versus spent today, however. And of course there's the potential for returns to break the other way. If her account lost, rather than gained, 12% in 2022--a not unreasonable possibility given the market's action today--she would have been better off taking out her RMD early rather than risking a larger sum in the market and taking her withdrawal later on. But because stocks and bonds more frequently gain in value than they lose, the benefits of an additional year of compounding can add up.

For retirees who are reinvesting their RMDs in a taxable account rather than spending, the sole benefit of delaying RMDs is to have an additional year to take advantage of the tax deferral afforded by the IRA wrapper. If Anne doesn't need the RMD money to live on and plans to reinvest her RMDs in a taxable account, she'd obtain an additional year of tax deferral by leaving money inside the tax-deferred wrapper. In contrast with a plain-old taxable brokerage account, she won't be liable for any income or capital gains distributions that her holdings kick off as long as the money stays within the IRA. For example, let's say Anne takes her RMD early in 2022 and invests her RMD in a taxable account that also earns 12%. But because she's in a taxable account, she incurs a tax-cost ratio of 1%, bringing her aftertax return to 11%. Owing to the drag of taxes on her taxable account, her total net worth would be slightly behind what it would have been if she had let the money sit in the IRA for the full year, earning 12% without any tax levy,

before taking her distribution.

*Why avoid it:* Those tax-deferred compounding benefits could add up for very wealthy retirees but may not be a big deal for smaller investors. For one thing, the post-RMD period is usually shorter than the accumulation period; the longer the time frame, the bigger the compounding benefit. It's also worth bearing in mind that most retirees' portfolios are more conservative, and therefore lower-returning, than accumulators', so the compounding and/or tax-deferral opportunity afforded by delaying may not be extreme.

Moreover, delaying RMDs can bite back. If you wait until after the holidays to tackle this piece of business, you run the risk of not being able to extract your RMD on time, thereby flirting with the 50% penalty discussed above. Another risk, especially for older retirees, is if you die late in the year, before taking your RMD, you could be leaving heirs with a tight window to take RMDs from the account.

Finally, waiting isn't advisable if you think you want to convert any of your IRA assets to Roth, because you'll need to take your RMDs before undertaking a conversion.

**Option 2: Take As Soon As Possible**

*Why consider it:*The big benefit to taking RMDs as soon as possible is to ensure that you don't forget and risk a 50% penalty. That also removes the possibility that you would leave your heirs with a tight window to take RMDs if you died. If an IRA conversion is on your radar, taking an RMD early in the year frees you up to do that later on. Finally, as discussed above, if a retiree is pulling RMDs for living expenses but the IRA subsequently drops in value throughout the year, she'll have been better off taking the money out earlier, leaving less money at risk of losses.

*Why avoid it:* There might be forgone tax-deferred compounding opportunities, as outlined above. Moreover, in particularly bad market environments like March 2020, Congress might vote to not require RMDs in a given year. Retirees who took their RMDs early may have to jump through some hoops to get the funds back into their accounts.

**Option 3: Space Throughout Year**

*Why consider it:* Taking distributions semiannually, quarterly, or monthly, with those distributions equaling the full-year RMD amount, helps ensure that you receive a range of prices for the assets that you sell. Just as dollar-cost averaging ensures that you never buy at the precisely right or wrong time, taking RMDs in installments guarantees that you'll never sell at precisely the right or wrong time. A retiree taking RMDs in installments would retain some, but not all, of the benefits of tax-deferred compounding afforded the retiree who takes a year-end distribution.

While it might seem logistically more difficult to take multiple RMDs throughout a given year, most financial providers have RMD services that calculate and disburse installment amounts on the schedule you dictate: monthly, quarterly, or semiannually. (Remember, your RMD amount is based on your balance at the end of the year prior. Thus, even if your portfolio fluctuates over the following year, your RMD amount is already set.) The other big advantage of receiving RMDs in installments is that it helps ensure regular cash flow from your portfolio. If you're paying quarterly estimated taxes throughout the year, taking intrayear distributions can also help you sync your withdrawals with your tax payments.

*Why avoid it:* There aren't major drawbacks to taking RMDs in installments, but if you're taking RMDs manually throughout the year, rather than relying on your investment provider's service, there's a risk you could miscalculate or fail to take all of your distributions. In addition, depending on the service your provider offers, you may not be able to engage in the sort of surgical RMD-taking that can enhance returns and reduce risk.

## Takeaways

In the end, the benefits of tax-deferred compounding by taking RMDs later in the yearâ€”or the forgone benefits of taking them earlyâ€”won't tend to be a huge determinant of an investor's take-home return. That's especially true for investors with shorter holding periods/life expectancies.

Instead, the decision about when to take RMDs will tend to be less important, in terms of portfolio performance, than will the decision about *where* to go for RMDs. By surgically pruning the most appreciated portions of the portfolio to meet RMDs, a retiree can systematically reduce the risk, and potentially enhance the return, of her portfolio. Such a strategy can be readily undertaken as part of a year-end portfolio review, which has the salutary benefit of increasing the opportunity for tax-deferred compounding, but it can also be employed at the outset of or throughout the year.