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## The Links between Golf and RMDs

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By Kerry Pechter     Thu, Dec 6, 2018

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*RMDs produce zero change in a client's wealth. They just create a 'balance sheet' adjustment, where money moves from a pre-tax to an after-tax account, current taxes get paid, and future tax liability goes down. So why do RMDs cause so much angst?*

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What if the late, great Arnold Palmer had designed a golf course where the first nine holes were all played downhill and the back nine were all played uphill—only the back nine weren't as steep as the front nine?

That arrangement could be inconvenient, it's true. Golfers would finish their round at a lower elevation than where they started, and have to drive their carts uphill back to the clubhouse.

If he'd developed such a course, the cardigan sweater-wearing Palmer, while drinking his trademark iced tea-and-lemonade, might have been inspired by the US tax code and the required minimum distributions (RMDs) that 401(k) participants and IRA owners have to take from their tax-deferred accounts. The first distribution is due by April 15 of the year after the year they turn 70½.



Arnold Palmer in his prime

Ideally, they should benefit from so-called “tax deferral.” Most retired people (on life's back

nine) will pay taxes on distributions from 401(k)s and IRAs at a rate lower than the rate from which, as working people (on the front nine), they sheltered their contributions.

Despite enjoying a net gain from tax deferral, many wealthy retirees dislike this arrangement. For instance, someone with a \$500,000 401(k) might need to withdraw about \$15,000 a year or more from the account after age 70. At a 25% tax rate, that means a \$3,750 tax bill on money that HNW retirees didn't need for current expenses.

Sure, they can reinvest the remaining \$11,250 in a taxable account (or give it to children or charity) but there's still the hassle and the cost—like facing an uphill walk back to the clubhouse after your round of golf—and perhaps the fear that a mistake will result in a penalty.

Michael Kitces, the well-known advisor-speaker-blogger, seems to think that RMDs are not a big deal. Speaking at the Investment & Wealth Institute's Retirement Management Forum this week in Florida, he compared RMDs to forced Roth IRA conversions after age 70½. RMDs produce zero change in a client's wealth, he said. They just create a "balance sheet" adjustment, where money moves from a pre-tax to an after-tax account, current taxes get paid, and future tax liability goes down.

### **A 'necessary evil'**

The dreaded RMD was recently the subject of a survey of about 800 Americans ages 65 to 75 with \$750,000 or more in savings (\$500,000 if unmarried). "RMDs have long been thought of as a necessary evil," said Paul Kelash, VP of Consumer Insights, Allianz Life, in a press release this week.

More than half (57%) of those surveyed said they want the disbursement and tax payment to occur "without getting involved." Most significantly, the survey showed that about 80% of those ages 71 to 75 don't need the money for current expenses and would rather leave the money to family or to charity.

Congress is aware of the pain associated with taking RMDs, and the House Family Savings Act of 2018, now awaiting reconciliation with a similar Senate bill, includes a tiny gesture of relief. Under the bill, retirees with less than \$50,000 across all tax-deferred retirement plans (other than defined benefit plans) would be exempt from RMD rules.

But that's a solution in search of a problem. Retirees with less than \$50,000 presumably need their distributions for current expenses, and would withdraw money from their tax-

deferred accounts even without a distribution requirement.

### **Why worry?**

I understand the pain associated with RMDs. In part, it's the nuisance of an unplanned, unexpected tax bill. A 75-year-old with a \$500,000 401(k) would have to withdraw almost \$22,000 and (at a 25% tax rate) would owe \$5,500 in income taxes on the distribution. He or she can invest the remaining \$16,500 in a taxable account.

But there's another source of pain. Taxes notwithstanding, many people (anecdotally) don't like the feeling that the government is invading their space. My late father-in-law used to complain about RMDs. He regarded the entire distribution as ill-gotten gains and, fortunately, gave it to his children.

Though I didn't want to discourage that practice, I reminded him each year that he was a net winner from tax-deferral (because of his lower tax rate in retirement) and that in a world without RMDs, there'd be no tax deferral in the first place.

If people resent RMDs and don't need the distribution for current expenses, it implies two things: First, that we should consider "Rothifying" the 401(k) system (eliminating tax deferral and the need for RMDs); Second, that we should cap or eliminate tax deferral for HNW participants, because so few of them seem to need it. I haven't heard anyone say that they'd prefer that to RMDs.

My father-in-law, by the way, was no duffer. A hilly back-nine wouldn't have troubled him at all.

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