Ten Thought Provoking Ideas on What to Do with Your Required Minimum Distributions (RMDs)

As you may or may not know, Congress (the opposite of progress) extended the age for RMDs from 70 ½ to age 72 starting in 2020. That's good news for those who want to continue to defer taxes another year or so.

So, what exactly should you do with the money you receive from your RMDs each year? Great question.

Before I offer you some suggestions, it's important to determine how much you will be required to take out. According to the most current IRS distribution worksheet, a 72 year old must withdraw about 3% from their retirement funds based on the December 31st balance from the previous year.

In other words, if the sum total of all your retirement funds was $100,000 on December 31st, you will need to take out around $3,000 the following year. If your year-end balance was $250,000, you'll need to take out around $7,500 the following year. Your distribution on a half million-dollar retirement account would be $15,000 and $30,000 on a one-million-dollar portfolio, got it?

Now that we have completed the math, let's take a look at some of the creative and interesting ways to best use your retirement funds.

1. REINVEST YOUR DISTRIBUTIONS

   Consider reinvesting your funds in tax-free municipal bonds or a tax-deferred annuity. Both are relatively safe investments and can provide tax advantages for you and your family. They can also provide monthly or quarterly income if you need it.

2. FUND A ROTH OR TRADITIONAL IRA

   You can contribute up to $7,000 per year, per spouse as long as one of you still has earned income. Roth IRAs grow tax-free. Traditional IRAs grow tax-deferred and may also be tax-deductible[1], therefore reducing your income tax liability.

3. PAY DOWN YOUR DEBT
   Pay off your mortgage or equity line of credit.
   Pay off your credit cards
   Pay off any auto loans

[1] Depending on your income

My guess is that the interest rate you are paying for any debt obligations you have is higher than what banks are offering on savings accounts or CDs. It's simple math – pay them off.

4. USE YOUR RMD TO PAY FOR LONG TERM CARE INSURANCE

There is a very high likelihood that at least one spouse could end up in an assisted living facility, need in-home care or a nursing home. The current average cost of a nursing home is anywhere from $60-$90k per year, depending on where you live. A prolonged stay can potentially wipe out your savings and investments!

We insure our homes, our cars and our lives, shouldn't we insure our life savings? The best way to do so is by protecting ourselves against the high cost of a nursing home stay, by purchasing long-term care insurance.

There are alternatives to buying a long-term care insurance policy. For example, the IRS will allow you to exchange (under section 1035) an older life insurance policy (if you qualify medically) to a newer policy with long-term care benefits. You can also exchange an older life insurance policy to an annuity with a long-term care rider without any medical requirements. Another option is to exchange an annuity that doesn't have a long-term care rider to one that does. By taking advantage of any of these upgrades you can help protect your nest egg against being wiped out by a lengthy nursing home stay.

5. HOME IMPROVEMENTS, ADDITIONS AND UPGRADES

It's not a bad idea to enhance the value of your home with retirement money you must take at age 72. Updating a kitchen or putting an addition on your home can turn out to be a good investment[2].

[2] Your wife told me to write this!

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6. GIFT YOUR RMD TO YOUR CHILDREN OR GRANDCHILDREN

   Under current law you can give up to $15,000 to each of your kids or grandkids as a tax-free gift. It's a great way to keep them close to you!

7. TRAVEL

   How does a family reunion on a cruise ship sound? What a great way to spend quality time with a captive audience. They will, no doubt, remember the experience for years to come. If spending a week on a ship with the whole family sounds a bit stressful, why not head to Hawaii or the Amalfi Coast in Italy with your sweetheart and take that vacation you've always been dreaming about?

8. DONATE YOUR RMD

   This can make a lot of sense for many reasons. First and foremost, the charity or church will really appreciate your donation. Most non-profit organizations run on very tight budgets. Secondly, you might be able to save a bundle on your taxes. As you know, you will have to pay state (if applicable) and federal income taxes on your RMD. By donating them, you get an off-setting deduction if you itemize on your tax return. You get to reduce your tax liability and feel good about helping others! What's better than that?

9. PAY FOR YOUR GRANDCHILDREN'S COLLEGE TUITION

   Why not use your RMDs to fund a 529 college savings plan for your children's children? The money grows tax-free if used for higher education. Your kids will thank you for helping them shoulder some of their financial burdens. The current average cost of a private university is around $45k per year in the good old USA. That's an incredible amount of money to spend for a four year degree, almost $200k! Your grandkids will have something very tangible to remember you by.

10. Leave a legacy

A lot of my investment clients have a desire to leave a legacy to their family, church, or favorite charity. One of the most cost-effective ways to do so is through the purchase of life insurance. One of the easiest ways to pay the premiums is from your RMDs. Here's two of the biggest reasons for considering this strategy:

1. The proceeds from life insurance goes to your heirs completely 100% tax-free. That's a very big deal!
2. A fairly healthy 72 year old can buy a $100,000 life insurance policy for around $2,000 - $3,000 per year, depending on the type of policy.

Think about the numbers for a couple of minutes. By buying a life insurance policy, your beneficiaries will receive the $100k tax-free death benefit immediately. On the other hand, you would have to live to age 105 for your heirs to receive the same amount of money by giving them $3,000 per year from your RMDs. Do the math – it's a no brainer. What a great way to leverage your RMDs, what a great return on investment.

So, there you have it. Ten great options on how to best use your Required Minimum Distributions. Choose wisely – once they're gone – they're gone.

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WHY I LIKE RETIREMENT!

QUESTION: How many days in a week?
ANSWER: 6 Saturdays, 1 Sunday

QUESTION: When is a retiree's bedtime?
ANSWER: Two hours after falling asleep on the couch.

QUESTION: How many retirees does it take to change a lightbulb?
ANSWER: Only one, but it might take all day.

QUESTION: What's the biggest gripe of retirees?
ANSWER: There is not enough time to get everything done.

QUESTION: Why don't retirees mind being called Seniors?
ANSWER: The term comes with a 10% discount

QUESTION: Among retirees, what is considered formal attire?
ANSWER: Tied shoes.

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