Making the Most of an RMD

By Stacey Freed

A member gets help turning retirement account distributions into an inheritance for his children.

Age 70½ may seem like an odd milestone, but for many people it's decision time. What will you do with the required minimum distributions (RMDs) that you now must take annually?

That was the case for longtime Thrivent member Donald Mortensen when he was required to take minimum distributions from his two IRA accounts. Most retirement savings accounts require these distributions, with the exception of Roth IRAs (see "Learn More" on page 9 for details).

The retired packaging engineer in Racine, Wisconsin, felt he had sufficient income from his 401(k) and his pension. He needed only a portion of the RMD for himself. What he really wanted to do, he says, was "make sure my kids, now 33 and 36, would be well taken care of after I am gone."

But he couldn't take just part of the RMD. If he didn't take the full RMD, he'd face a tax penalty from the IRS, says Shawn Mees, a financial professional on the Thrivent Financial Guidance Team® (TFGT). "If you ignore it and don't take the money, the government will take 50 percent of the RMD in addition to the ordinary income tax on the distribution," Mees says.

As the two began talking about options to reinvest the RMD, Mortensen made it clear that he preferred a conservative approach to investing at this point in his life. He wanted something he could invest in for about a decade that would deliver a good return and would be relatively stable.

Mees and Mortensen discussed several options.

"We first looked at a mutual fund solution but shied away from that," Mees says. "Donald wanted to avoid any tax consequences and was simply looking to pass along money to his children income tax-free."

They also looked at a life insurance contract that has a guaranteed death benefit and a cash value component.

"We looked at a whole life 10-pay insurance contract where Donald would pay premiums using his RMDs for 10 years and then no longer have to pay premiums because the product would be fully funded at that point," Mees says. But Mortensen wanted something with a higher death benefit than what the 10-pay could offer.

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The Solution

With the other options off the table, Mees suggested using Mortensen's existing universal life (UL) insurance contract. Doing so would help Mortensen meet his goal of leaving more money and reducing or eliminating the tax burden to his heirs.

Mortensen would be able to keep some of his RMDs for expenses and contribute some to the UL contract for 10 years. After that? "If all of the nonguaranteed assumptions in the illustration are realized, then the death benefit may grow," Mees says. "This may give him a higher death benefit in the future."

Mortensen also is able to surrender or borrow the cash value from the UL, and his children may not have to pay taxes on the inherited money. That's because beneficiaries of life insurance proceeds typically don't have to include that money in their gross income they report to the IRS.[1]

"My children and I both benefit," Mortensen says. "I continue to have some money coming in every month and also can divert some to make sure they'll be taken care of. It's a way for them to get a nice little nest egg when I pass away, to help them with their expenses." ■

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A required minimum distribution, or RMD, applies to all employer-sponsored retirement plans, traditional IRAs, SIMPLE IRAs and SEP IRAs (but not Roth IRAs). The owner must begin distributions no later than April 1 of the year after they reach 70½ years of age.[2] Your RMD is determined by dividing your account's previous year-end value by the IRS' predetermined life-expectancy figure. "For example, if you have a $100,000 investment and the account holder is 75 years old, then the life expectancy factor is 22.9, according to the IRS Uniform Lifetime Table.[3] That results in an RMD of $4,366," says Shawn Mees, a financial professional on the Thrivent Financial Guidance Team®. Your RMD is recalculated each year based on your current age.

Generally, the RMD money is subject to taxation because it was originally invested pretax. Roth IRAs, however, are funded with after-tax dollars and don't require withdrawals until after the owner dies (beneficiaries of Roth IRAs are subject to RMDs). Talk to your financial professional about any questions you have regarding RMDs.

[1] "Life Insurance & Disability Insurance Proceeds," Dec. 6, 2017, IRS
[2] "Retirement Plan and IRA Minimum Distributions FAQs," May 30, 2018, IRS
[3] "Publication 590-B (2017), Distributions from Individual Retirement Arrangements (IRAs)," 2017, IRS