RBC Wealth Management

Ending the Year on a High Note:

Five Year-End Retirement Strategies to Bring You Closer to Financial Success

We're approaching a time of year that can be both exciting and frightening: exciting because now is the time you realize your value with the help of your financial advisor—especially in regards to retirement and planning—but frightening because it's the time when poor decisions are being made about minimum distributions, asset appreciation, and Roth conversions. Important exemptions are often forgotten. People can be careless when it comes to missing deadlines and valuable opportunities on things such as charitable deductions, and they're later forced to suffer the consequences of this negligent behavior.

With this time of year being so critical, it's important to reach out to an advisor as the year winds down for assistance with five items in particular:

1) **Required minimum distributions.** Referred to as RMDs for short, these are an annual IRA tradition popular in the world of financial advising, but they can be tricky due to computational errors or as distributions fall through the cracks. This can be costly because if you miss your required minimum, you're likely to get hit with a hefty 50% penalty on any distribution amount you should've taken. While it's true that this penalty can often be waived by the IRS, who wants to bear the anxiety of dealing with the IRS if it can be avoided?

   As advisors, we keep close track of every client who is subject to RMDs by year's end. While we have our regulars, we also have those clients who are not so obvious that fall into this category—including those who fall into the category for the first time. Those who are a part of this group may vary, as it encompasses newcomers to the 70½ club, or sophomores who have two RMDs this year and required distributions for IRAs or Roth IRAs that they've inherited (including trusts that are IRA beneficiaries). Roth 401(k)s are also subject to required minimum payouts (although Roth IRA owners aren't).

2) **Qualified charitable distributions (QCDs).** The Tax Cuts and Jobs Act of 2017 offered taxpayers help through an expanded standard deduction; however, this act also means that many will no longer be able to deduct their charitable contributions because they most likely won't itemize their deductions. If you have an IRA that is subject to an RMD and you have not yet taken it for the year, contact your financial advisor immediately for advice on how to use the QCD provision and make contributions directly from your IRA.

   In essence, the amount contributed will count toward your RMD and can be excluded from income, creating an effective tax deduction along with the standard deduction. It's important to note, though, that the QCD only applies to IRAs—not to plans—and only IRA owners or beneficiaries who are least 70½ years old qualify. Donor-advised funds and private foundations are not eligible for the QCD, and nothing be received in return for the gift. The annual limit is $100,000 per person, per year.

   If you're contemplating a large onetime donation, keep in mind that you can still do the QCD even if the gift exceeds the required RMD amount, as long as it remains under the $100,000 limit. In this circumstance, giving more than the RMD removes more IRA funds that will then not fall under income. QCDs also lower adjusted gross income, which may help you with other tax benefits or deductions. QCDs lower tax bills, but to count for 2018, it's important that a QCD is completed by year's end.

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3) **Roth conversions.** The major IRA planning change in the new tax law was for Roth conversions. Beginning in 2018, conversions can no longer be reversed. They'll be permanent and the tax will be due once the funds are converted. Roth conversions may still be valuable for you, but now any conversions considered for 2018 must be prudently planned and the tax bill accurately projected. Unlike an IRA contribution, which you can make until April 15 of the following year, the funds must leave the IRA or plan by year's end to qualify for a Roth conversion this year.

   We, as advisors, must also take other new tax charges into consideration when projecting the tax on a Roth conversion, along with the usual items such as taxability of Social Security, increases in Medicare Part B and D premiums, the effect on financial aid for students, etc. You may lose sizable tax deductions this year (capped at $10,000), and the increased standard deduction may not make up for the loss. Big casualty losses may not reduce the tax bill on a Roth conversion either, unless they're in a federally declared disaster area.

   If you're a business client, it's essential that we check whether a Roth conversion has an effect on the new 20% deduction for qualified business income. Although this may seem like a reason to avoid a Roth conversion, keep in mind that these are only short-term problems in tax planning, as the additional taxes would only be for the year of the conversion. Nevertheless, it's important that these issues are discussed before you, as a client, commit to a Roth conversion that can no longer be undone.

4) **Advisors should check estimated taxes on RMDs (use withholding).** If you're new to RMDs, we check to see if you already have enough money withheld or paid in through estimated tax payments to avoid penalties. If you came up short on your payments, consider withholding taxes from year-end IRA distributions. The tax withheld is thought to be paid evenly through the year and satisfies the estimated tax payment timing requirements.

   This is particularly done with RMD clients when the distribution is the main item necessitating quarterly estimated tax payments. Clients often withhold the projected tax due for the year from their required distribution, and they love evading the quarterly estimates. We coordinate with our clients' tax advisors to see if the IRA withholding can be used to cover other income items during the year. The reason the IRA withholding is able to work so well is because this RMD money is usually not needed. The required RMD often goes directly to an investment account, so instead of writing tax checks during the year, it's better to do so through IRA withholding.

   For older clients who may not be making the required tax payments with the vouchers we send them, taking withholding from the IRA distribution can really make things easier for the family, as it removes any penalties and additional taxes due at tax time. In some cases, we increase the withholding tax to cover not only the year's tax liability, but also the first quarter of the next year—meaning that there's no balance due by April 15. This eases pressure for you as a client.

5) **Year-end tax planning.** Throughout the course of the year, you may have incurred capital gains from the sale of appreciated stock. It's important to understand the total amount of capital gains you have because they can impact your overall tax situation. In light of this, it may make sense to ask yourself the following:

   1. Do I have any capital loss carrying forward from previous years?
   2. Do I have securities with losses that I want to sell to offset gains? If you think the long-term outlook on these securities is still positive, you can buy them back after 31 days to avoid the wash sale rule.
   3. If you own mutual funds, the end of the year is a good time to review expected capital gains. Most mutual funds pay capital gains from mid-November through year-end. These capital gain distributions can vary dramatically from year to year.

As the year comes to an end, it is critical that you—as a client—contact your financial advisor to discuss these five important parts of your financial plan and to understand your value as the year winds down. After working hard all year to be rewarded, don't let the final days of the year be a time for careless mistakes that you'll regret later on. Here at RBC Wealth Management, we want to make sure that your 2018 ends on a positive note.

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