Planning Your Required Distributions

For those in or near retirement, the age of 70½ is a key transition point: Retirees need to begin planning for required minimum distributions (RMDs) that are taken annually from employer-sponsored retirement plans and traditional IRAs. Understanding the rules can help to ensure that you take these distributions in a manner that is best suited to your personal situation.

IRAs

For a traditional IRA, you must begin withdrawals by April 1 following the year in which you reach age 70½. The amount that you must withdraw is based on your age with one exception: If you have a spousal beneficiary who is more than 10 years younger than you, the amount of the RMD is based on your joint life expectancy. If your distributions are less than the required minimum, the IRS assesses a penalty equal to 50% of the difference. RMDs are not required from Roth IRAs.

Employer-Sponsored Plans

For 401(k)s, 403(b)s, and other employer plans, the same rule about beginning withdrawals by April 1 following the year in which you reach age 70½ still applies. However, if you continue working beyond age 70½ and do not own more than 5% of a company, you can delay RMDs until your retirement.

In addition, qualified individuals may take a lump-sum distribution in which they withdraw assets from 401(k), profit-sharing, and stock purchase plans within a one-year period. If terms of the lump-sum distribution are met, the taxable portion is taxed at special rates based on levels for single taxpayers in 1986. Those born before 1937 qualify for 10-year forward income averaging. RMDs from qualified retirement accounts are taxable as ordinary income.

Calculating the Amount

In most instances, the financial institution where you maintain the account determines the amount of your RMD. The formula involves dividing your balance as of December 31 by your life expectancy, and the resulting amount is your distribution. Although these rules may appear cut and dry, there is flexibility that retirees may want to consider:

- You have the option of taking the initial RMD in the year in which you turn 70½ or waiting until the following year, as long as the withdrawal is taken by April 1 of the following year. Keep in mind that if you delay your RMD until the following year, you will be required to take two RMDs that next year, which could potentially push you into a higher tax bracket.
- You may also take your RMD as a series of withdrawals throughout the year, which could be convenient if you are using the withdrawals for ongoing living expenses.
- When planning for distributions, be sure to keep your beneficiary(ies) up to date. Married participants in employer-sponsored retirement plans are required to name their spouse as beneficiary unless the spouse waives this right in writing. For an IRA, account holders may designate whomever they wish.

Planning for RMDs is complex. Before beginning your distributions, you may want to consult the financial institution where your assets are housed, your financial advisor, and your tax advisor to make sure that your planning efforts are successful.

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