Fall in Line on Required Minimum Distributions

Observe tax rules for qualified plans and IRAs

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The IRS not only limits the amount you can contribute to qualified retirement plans and IRAs while you are working, it tells how much you must withdraw when you are retired. Under the rules for “required minimum distributions” (RMDs), you may have to take distributions before the end of the year—whether you want to or not.

Background

Distributions from qualified retirement plans and IRAs are taxed at ordinary income rates reaching as high as 35% in 2012. In addition, you must pay a 10% penalty tax on distributions received prior to age 59½, unless a special exception applies. (On the other hand, RMDs are not required for Roth IRAs.)

Usually, you must begin taking RMDs no later than April 1 of the year following the year you turned age 70½. For instance, if you turned age 70½ this year, the first distribution must occur by April 1, 2013. Then, you will have to take another distribution for the 2013 tax year by December 31, 2013. To avoid doubling up, you might arrange to take your 2012 tax year distribution this year. Once you pass age 70½, you must continue annual distributions year-in and year-out.

There is an exception to these rules if you still work on a full-time basis and you do not own 5% or more of the employer. In this case, you can postpone RMDs until your retirement. But, this only applies to the money being held by your employer's plan. If you own other, non-work related accounts, such as an IRA other than a Roth, you've got to start taking the money from that account now.

So how much do you have to withdraw? The amount of the annual RMD is based on IRS life expectancy tables for the participant and the value of the account on the last day of the previous year. In other words, your RMD for the 2012 tax year depends on your balance as of December 31, 2011, even though you’re taking out the funds almost one year later.

If you fail to comply with these rules, the IRS may impose a harsh penalty equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and a lesser amount actually withdrawn). The penalty is added to the regular income tax that is due on the RMD. To avoid any potential problems, make plans to take distributions well in advance of the December 31 deadline.

Final words

Consult your Henry & Horne, LLP adviser regarding the rules for distributions from qualified retirement plans and IRAs.

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