Understanding Minimum Distribution Rules

If you're approaching retirement, you'll eventually need to make serious decisions about when to begin taking withdrawals (known as distributions) from your retirement accounts, how to receive the money and how to calculate the taxes you'll owe.* Fortunately, the rules governing required minimum distributions (RMDs) have been simplified in recent years. Still you should exercise caution to ensure that you're following the rules correctly.

The Basics

Many people begin withdrawing funds from their IRA and 401(k) soon after they retire. Before age 70½, when and how much you withdraw is your decision. After that, failure to withdraw the so-called RMD amount each year may result in substantial tax penalties to the tune of 50% of the amount that you failed to withdraw. For example, if your RMD was $20,000 and you only withdraw $15,000, your penalty will be 50% of the $5,000 that you didn't withdraw.

For IRAs, you must begin taking RMDs no later than April 1 following the year in which you turn 70½. The same generally holds true for 401(k)s and other qualified retirement plans. However, RMDs from a 401(k) can be delayed until retirement if you continue to be employed by the plan sponsor beyond age 70½ and you do not own more than 5% of the company. If you have a Roth IRA, you are not required to take distributions at any age. In addition, the minimum distribution rules do not apply to annuities funded with after-tax dollars.

What If I Have Multiple Accounts?

Your RMD for a particular tax year is based on the total of all your qualified plan assets (e.g., IRAs and 401(k)s if you're no longer working for the company). In addition, you are not required to take RMDs from each account in an amount that's proportional to each respective account's value. Simply put, you can decide which accounts you want to take money from, so long as you remove enough in total to cover your RMD for that year. This brings up an important point. One way to simplify the RMD process, as well as gain better control of your various retirement accounts, is to consolidate them into one rollover IRA. By doing so, your retirement assets will be in one place, and you may better ensure that the management of those assets is consistent with your needs and goals.

Next Steps

A good starting point for understanding the RMD rules is to familiarize yourself with IRS Publication 590. It's available for free at the IRS website or at your local IRS office. Should you have questions, I can help you determine your RMD amount as well as help you develop an investment strategy that makes sense for you.

**Withdrawals will be taxed as ordinary income tax rates. Withdrawals before age 59½ may trigger a 10% penalty tax.*