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Frequently Asked Questions Required Minimum Distributions from IRAs

Introduction

Many retirees have large IRAs that grow in value over years of saving and investing in qualified retirement plans. However, the government is seeking the tax revenue from lifetime earnings that have been deferred in IRAs throughout their working years. In order to collect tax revenues, the IRS stipulates that retirees must, at a point in retirement, begin to take withdrawals from their IRAs. These withdrawals are known as Required Minimum Distributions (RMDs).

This paper provides answers to some common questions related to RMDs that are frequently asked by retirees. For a better understanding of how RMDs may impact your particular situation, we encourage you to discuss your specific circumstances and RMDs with your tax accountant.

1. I am retired. What are RMDs and when do they begin for me?

Beginning with the year in which you turn 70½, you are required to take withdrawals (RMDs) from your IRA. The withdrawals apply to Traditional IRAs, SEP IRAs, SIMPLE IRAs, and Rollover IRAs. The withdrawals also apply to some 401(k)s, 403(b)s, and 457s. The distributions do NOT apply to Roth IRAs (except for Inherited Roth IRAs) or to other portfolios with Roth designations, such as Roth 401(k)s. Inherited Roth and Traditional IRAs are also typically subject to RMDs that may begin immediately regardless of age.

The size of the annual distribution is calculated by combining the market value of all of your IRAs on December 31 of the previous year and dividing this amount by a factor that is found in one of a few tables that is provided by the IRS. Most individuals, including single individuals and married couples (where the spouses were born within ten years of one another), would use the IRS Uniform Lifetime Table (shown in the Appendix at the end of the paper). Once again, the process for inherited IRAs may be similar, depending on age and relationship to the deceased.

It is important to understand that the calculated withdrawal is the minimum that must be taken out. You may, however, take out more than this amount. In fact, as long as you are at least 59½ years old, you may withdraw as much of the IRA as you wish without penalty, although the withdrawals are taxed as ordinary income.

Example:

Assume that it is 2017. There is a married couple with a husband who turns 72 during the year (DOB 06/15/1945) and a wife that turns 68 during the year (DOB 09/15/1949). The husband has an IRA that had a balance of \$2,000,000 on 12/31/2016 and the wife has an IRA that had a balance of \$1,000,000 on 12/31/2014.

First, since the wife does not turn at least 70½ during the year, **the couple is NOT required to take withdrawals from her IRA.** However, since the husband turns 72 during the year, he must take a withdrawal that is at least equal to the RMD. Since the husband and the wife were born less than 10 years apart, the Uniform Lifetime Table is used (shown in the Appendix). For individuals who are 72, the “factor” that is used is 25.6. Therefore, the husband takes his market value from December 31, 2016 and divides this by 25.6. **Based on this calculation, the husband must take out at least \$78,125 from his IRA in 2017.** He can choose to take more than this amount and his wife can choose to take money out of her IRA this year. However, if he chooses to take out less than \$78,125 he will be forced to pay a steep penalty.

2. How do I find out the exact amount that I must withdraw?

After January 1st each year, bank custodians will generally send information to clients that explicitly state the dollar amount that must be withdrawn from the IRAs that are held with that custodian in order to meet the RMD (if a custodian does not send you this information, you may request that they calculate the RMD for you). If an individual has multiple IRAs held at multiple institutions, each custodian will send information on the amount that must be withdrawn from that respective IRA. However, it is important to understand that the “total” RMD may be withdrawn from some or any of the IRAs, and does not need to be partially withdrawn from each account. It is up to the IRA account owner, not the custodian, to ensure that they have withdrawn a sufficient amount in order to avoid penalties. The exception to this flexibility is with 401(k)s, since 401(k) RMDs must be taken from that specific account.

3. What is the penalty if you forget to take out RMDs?

The penalty is 50% of the amount not withdrawn from IRAs, PLUS the applicable income tax that is owed. Given the magnitude of this penalty, it is important that individuals verify with their custodians that the required amount has been withdrawn from their accounts.

4. How do RMDs work the year that I turn 70½?

The rules for the first year's RMDs can be somewhat confusing. First and most importantly, the law states that distributions begin the year in which you turn 70½. Based on this, half of the population "turning 70½" in a given year will ultimately turn 71 during that year and half will remain 70. This means, for the first year's withdrawal, half of the people will use the "age 70 factor" from the IRA tables and half will use the "age 71 factor" and, in fact, will skip the "age 70 factor."

Beyond determining which factor to use for the year in which you turn 70½, the first year's RMD has one other unique caveat. Specifically, you may delay the first year's RMD beyond December 31 of the year that you turn 70½ and instead must take the distribution by April 1st of the following year. While delaying the distribution until April may delay the tax an additional year, this may actually lead to higher total tax paid, since you will need to take two years worth of RMDs during one tax year, resulting in a higher effective income tax rate that year.

April 1 of the year following the year that you turn 70½ is known as the "Required Beginning Date." The Required Beginning Date is an important date that will reappear in this text as it pertains to RMDs for IRAs once they are inherited.

5. I have heard that my RMD is calculated from a table and that many tables exist. How do I know which one to use?

As the answer to Question 1 discussed, multiple tables exist and it is important to ensure that the correct table is used when calculating the RMD. For individuals and married couples where the spouse is less than 10 years younger, the Uniform Lifetime Table is used (shown on page 6 in the Appendix). For married couples where the spouse is more than 10 years younger and is the sole beneficiary, the Joint Life Table is used. Finally, for inherited IRAs (discussed under Question 13), the Single Life Expectancy Table is used (shown on page 7 in the Appendix). While many tables exist, it is the job of the IRA custodian to calculate the RMD for you.

6. What circumstances may impact the size of my RMDs?

Once age 70½ is attained, the size of RMDs will change each year. Based on the formulaic nature of the distributions, it is easy to see that the key determinants in the size of the distribution are:

- the value of the IRA at the end of the previous year
- the age of the account owner
- the table used

Holding all else equal, the larger the IRA and the older the account owner, the larger the size of the RMD.

7. How are RMDs taxed for Federal income tax? What about on the state level?

Distributions from IRAs are taxed as ordinary income on Federal income tax returns. Furthermore, given the progressive nature of the Federal income tax system, each dollar of income is taxed at higher and higher rates. As such, when large withdrawals are taken from IRAs, this can push individuals into higher tax brackets and may result in a higher effective and marginal income tax rate for the tax year.

Beyond Federal income tax, many states impose state-level income tax on IRA distributions. While this report does not delve into the intricacies of each state's income tax system, most states which have a state income tax on ordinary income will tax IRA distributions. A few exemptions exist. For example, Pennsylvania, Massachusetts, New Jersey, Illinois, and Mississippi do not tax retirement income, while New York excludes \$20,000 in income per year. Furthermore, seven states do not impose a state-level income tax at all (i.e., Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming), while states such as Tennessee only tax dividends and interest. It is important to understand that the taxation of retirement benefits continues to evolve over time and while one state's laws may be more beneficial today, it is unknown if they will be beneficial in the future. We strongly recommend that you discuss your specific circumstances with a tax accountant who specializes in the state in which you reside.

8. If I am still working do I need to take RMDs?

Whether you are working or not, you need to take RMDs from an IRA portfolio. However, if you are still working and are an active participant in your 401(k), then you may not need to take RMDs. Specifically, as long as you are not a 5% owner of the company, you typically will not be required to take withdrawals from your 401(k) portfolio. However, it is recommended that you contact your plan administrator to understand the specifics of your plan.

9. Am I able to contribute to an IRA once RMDs begin?

Contributions to a Traditional IRA are not permitted beyond age 70½. However, you may still make contributions to a Roth IRA beyond age 70½, as long as you are below the income limits. Contributions are allowed to 401(k) plans beyond age 70½ for active plan participants.

10. I have heard that Roth IRAs are treated differently. Do I need to take RMDs from Roth IRAs?

Unlike Traditional IRAs, individuals do not need to take withdrawals from Roth IRAs. Roth IRA withdrawals are allowed penalty-and-tax-free once the account is at least five years old and as long as the individual is at least 59½ years old. Penalty-free and/or tax-free withdrawals are allowed in a few other situations as well.

11. Who has to take the RMDs in the year of the account owner's death?

In general, account owners must take the RMD in the year of their death. For example, if IRA owners die in 2015 prior to taking their RMD, one must be taken on their behalf before the end of the year (which may be done by their Executor). An individual inheriting the account would not be required to take an RMD until 2016.

12. My spouse died and I am the beneficiary of the IRA. What are my options?

There are generally three options (assuming that the surviving spouse is the sole primary beneficiary of the IRA). First, the spouse may take the IRA as their own IRA. This means that the RMDs would be calculated based on the surviving spouse's age. The second option is to take the IRA as a Beneficiary IRA (also known as an Inherited IRA). This typically makes the least sense, unless the two spouses have a significant discrepancy in age (more information on Inherited IRAs is included in Question 13). Lastly, the surviving spouse may disclaim the inheritance of the IRA. This will result in the IRA being paid out to the contingent beneficiaries. If the IRA owner dies before the Required Beginning Date (defined in Question 4) and the surviving spouse is also not yet 70½, then the surviving spouse can delay RMDs until they turn 70½ if they take the IRA as their own.

13. Someone other than my spouse died and I inherited an IRA. Can I roll this into my current IRA? How are they treated differently?

When you are the beneficiary of an IRA from someone other than your spouse, then you are required to inherit this IRA as a Beneficiary IRA (also known as an Inherited IRA). Whether you are the owner of an IRA or you have inherited the IRA as a Beneficiary IRA, the account will grow tax-deferred. However, a key difference between the two types of IRAs is how the RMDs are calculated. Specifically, a different IRS table is used (the Single Life Expectancy Table, shown in the Appendix) to calculate the first year's RMD from an Inherited IRA, and this initial calculation is used in the calculation of RMDs in subsequent years. Fortunately, IRA custodians can complete this calculation for you on an annual basis.

Since an IRA and an Inherited IRA have different RMD calculations, they may not be rolled into the same portfolio. Similarly, if you inherit IRAs from two different people, they will each have their own RMD schedules and, as such, will need to be held separately.

14. How do you calculate RMDs for an Inherited IRA?

RMDs for Inherited IRAs are initially calculated by using the Single Life Expectancy Table. First, in the year that the account owner died, the distribution is taken by the account owner (or on their behalf), not by the individual inheriting the IRA. As was discussed in Question 11, RMDs begin for beneficiaries the year after the year in which the account owner died. It is important to understand that beneficiaries must take RMDs no matter how young they are.

The first year's RMD is calculated by taking the beneficiary's age and calculating their life expectancy using the Single Life Expectancy Table (shown in the Appendix). For example, for a 60 year old beneficiary, the life expectancy factor is 25.2. You then divide this into the previous year's ending market value.

In subsequent years, rather than recalculating the RMD using the table, you subtract 1 from the factor. So, for this same beneficiary, the new factor the following year would be 24.2. This is repeated until the account is depleted.

While this is how RMDs work in most situations, it does not apply in all scenarios. For example, if the account owner has reached the Required Beginning Date and leaves the IRA to his estate, then the proceeds may need to be paid out within five years.

15. I have inherited a Roth IRA. I know that Roth IRAs do not normally have Required Minimum Distributions. Am I required to take any withdrawals out of this account?

The answer is yes. Even though a Roth IRA that is owned by the account owner does not have RMDs, an Inherited Roth IRA is treated differently. Specifically, the beneficiary of an Inherited Roth IRA is required to use the same table that is used when calculating the RMD of an Inherited Traditional IRA (i.e., the Single Life Expectancy Table). The key differentiating factor between Inherited IRAs and Inherited Roth IRAs is that withdrawals from Inherited Roth IRAs are not taxed for Federal Income tax. However, while the withdrawal is not taxed, the benefit of tax-free growth is gone.

16. I inherited an Inherited IRA. How does this work?

Once an IRA has been inherited once (not counting spouses who treat inherited IRAs as their own), the RMD schedule does not change. So, for all ongoing distributions from the inherited IRA, the RMD will be based on the age of the initial beneficiary who inherited the account the year that the account owner died. This is true even after the initial beneficiary of the IRA has died. For this reason, some people will choose to leave their IRAs to grandchildren (rather than children) in order to allow for a longer "stretch out" of the RMDs to younger beneficiaries.

Conclusion

This paper has outlined answers to some of the most common questions that retirees ask about RMDs. While this paper provides general education and answers that are applicable in most situations, it is important to understand that specific scenarios and unique situations may result in a distributions structure that is different from what has been outlined in this paper. As such, while this paper provides useful information, we encourage you to discuss your specific circumstances and RMDs with your tax accountant.

Appendix

Uniform Lifetime Table (IRS Publication 590-B, Table III)

For use by:

- unmarried owners,
- married owners whose spouses are not more than 10 years younger, and
- married owners whose spouses are not the sole beneficiaries of their IRAs.

Age	Distribution Period	Age	Distribution Period
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115 and over	1.9

Single Life Expectancy Table (IRS Publication 590-B, Table I)

For use by beneficiaries.

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	82.4	28	55.3	56	28.7	84	8.1
1	81.6	29	54.3	57	27.9	85	7.6
2	80.6	30	53.3	58	27.0	86	7.1
3	79.7	31	52.4	59	26.1	87	6.7
4	78.7	32	51.4	60	25.2	88	6.3
5	77.7	33	50.4	61	24.4	89	5.9
6	76.7	34	49.4	62	23.5	90	5.5
7	75.8	35	48.5	63	22.7	91	5.2
8	74.8	36	47.5	64	21.8	92	4.9
9	73.8	37	46.5	65	21.0	93	4.6
10	72.8	38	45.6	66	20.2	94	4.3
11	71.8	39	44.6	67	19.4	95	4.1
12	70.8	40	43.6	68	18.6	96	3.8
13	69.9	41	42.7	69	17.8	97	3.6
14	68.9	42	41.7	70	17.0	98	3.4
15	67.9	43	40.7	71	16.3	99	3.1
16	66.9	44	39.8	72	15.5	100	2.9
17	66.0	45	38.8	73	14.8	101	2.7
18	65.0	46	37.9	74	14.1	102	2.5
19	64.0	47	37.0	75	13.4	103	2.3
20	63.0	48	36.0	76	12.7	104	2.1
21	62.1	49	35.1	77	12.1	105	1.9
22	61.1	50	34.2	78	11.4	106	1.7
23	60.1	51	33.3	79	10.8	107	1.5
24	59.1	52	32.3	80	10.2	108	1.4
25	58.2	53	31.4	81	9.7	109	1.2
26	57.2	54	30.5	82	9.1	110	1.1
27	56.2	55	29.6	83	8.6	111 and over	1