

The Nuts & Bolts of Required Minimum Distributions

Given the uncertain future of Social Security and the decline in popularity of traditional pensions, saving for retirement is more important than ever. **Individual Retirement Accounts (IRAs)** and employer-sponsored qualified retirement plans provide valuable, tax-favored opportunities. However, along with the benefits come certain rules.

The Internal Revenue Service (IRS) governs the distribution of these savings during retirement with the required minimum distribution (RMD) rules. The RMD is the minimum amount that must be distributed to retirement plan owners beginning in the year the owner turns 70½. Rule changes finalized in April 2002 simplified many of the RMD regulations.

Required Beginning Date

Minimum distributions must be made on or before December 31st of each year. However, the first required minimum distribution may be postponed until April 1st of the calendar year following the year the IRA owner reaches age 70½. This is the "required beginning date."

For instance...Amanda (a hypothetical case) turned 70 on March 5, 2006 and 70½ on September 5, 2007. Her RMD is due December 31, 2007, but it may be postponed until the "required beginning date" of April 1, 2008. Her second RMD would be due on December 31, 2008.

Any participant in a qualified retirement plan who is not a 5% owner may postpone the required beginning date until April 1st of the calendar year following the year of retirement, if allowed in the plan document.

Just as there are penalties for withdrawing money too soon, there are penalties for not taking the RMD. A 50% excise tax is imposed for failing to take these required distributions.

A New and Simpler Table

The final regulations produced a new table for calculating the life expectancies that determine RMDs. Known as the **uniform lifetime table**, it reflects longer life expectancies, decreases the required minimums, and generally results in larger tax-deferred account balances.

Consider this hypothetical example. Joshua's (a hypothetical case) required beginning date was April 1, 2006. He is 71 and his wife is 72. The combination of his IRAs that total \$1,000,000 results in distributions of \$51,546 and \$37,736 under the reformed uniform lifetime table.

The joint life expectancy table is still available to use if the sole beneficiary is the participant's spouse and the spouse is more than ten years younger than the participant. This combination would result in an even smaller required minimum distribution.

Distributions Upon Death

With the reform, the single life expectancy table is generally used regardless of who is the designated beneficiary. Distributions must begin by December 31st of the year following the year of death and are based on the beneficiary's life expectancy. If there are multiple beneficiaries, the life expectancy is based on the oldest beneficiary, or separate accounts may be established for each beneficiary.

Spousal beneficiaries may elect at any time to treat the owner/participant's IRA as their own, and only spousal beneficiaries may roll over death benefits to their own IRAs. A spousal beneficiary may also delay the first distribution until the owner/participant would have reached age 70½.

Under the old rules, the beneficiaries were "fixed" as of the required beginning date. Under the new rules, beneficiaries have until September 30th of the following year to determine how the death benefit should be distributed.

IRS Eases Up On Rules

Taxpayers who take IRA distributions in a series of "substantially equal periodic payments" may be able to change the method of calculating these payments without incurring a 10% early withdrawal penalty tax. Due to the downturn in the market over the last few years, the account balances of taxpayers who chose the "fixed" methods are depleting more rapidly than they had expected. The IRS now allows a one-time election to switch to the RMD method without incurring any penalties. The RMD method permits the taxpayer to recalculate the payment using the life expectancy tables and the

account balance each year. Failure to follow IRS regulations could be costly. Knowing the rules can help you plan ahead and take full advantage of the important tax benefits qualified retirement plans offer.

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