Compute Required Distributions from retirement accounts

Once you retire or reach age 70 ½ (depending on your retirement plan), the law requires that you start making –at a minimum—some periodic withdrawals. These withdrawals are called required minimum distributions.

Why required minimum distributions?

First, the tax policy behind letting you save in a tax-deferred account was to allow you to use those funds in your retirement, rather than to use them as just another way to build up your estate for your heirs. Second, because those accounts are usually tax-deferred, withdrawals after retirement are taxed to you as ordinary income. As a result, the IRS wants you to withdraw at least a minimum amount from those accounts each year so that it can be taxed.

New IRS rules substantially simplify the computation of required minimum distributions (RMDs). In addition, Congress has forced the IRS to adopt new life expectancy tables that reflect longer life expectancies, resulting in distributions to be made over a longer time-period and for the RMD to be smaller than would have been required in previous years.

Good tax news

Good news for taxpayers who are interested in retaining funds in their IRAs and their tax-qualified plans because it means deferring income tax on the funds even longer.

If you are alive in the year in which you must begin required minimum distributions, your new MRD is calculated each year by dividing the account balance by your life expectancy, as determined by the uniform distribution period table (the "Uniform Table") in the new IRS rules.

> Example. At the time his required beginning date is reached (usually retirement or 70 ½), John Smith had a balance of $1 million in his IRA, as of the previous December 31. He previously named a beneficiary, who is age 67.

The difference in the computation of the RMD under the new rules is dramatic.

> Under pre-2001 rules, he checks the joint and last survivor table and finds that his divisor for his $1 million account is 22.
> Under revised rules in effect in 2001, his divisor is 26.2.
> Under the new Uniform Lifetime Tables now in effect, his divisor is 27.4.

The difference in required distributions is significant.

> Under pre-2001 rules, John must withdraw at least $45,454 this year

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> Under the 2001 rules, John must withdraw at least $38,168 this year.
> Under the new tables, John must withdraw at least $36,496 this year.

Because of the new regulations, John has an extra $8,958 in his IRA at the end of the year over what he could have kept under the rules only a few years ago. This amount can then continue to accumulate earnings. This savings can be realized—and compounded—every subsequent year for the next 27 years. As a bonus, John's federal income tax (assuming a marginal rate of 35 percent) is more than $3,135 less ($12,773 instead of $15,908).

If you die before reaching your retirement having designated your spouse as beneficiary, distributions must begin by December 31 of the year following your death or the year that you would have turned 70½, whichever is later. At that time, RMD is computed over your spouse's life expectancy.

Caution!

The new rules—although more flexible—leave little room for mistakes in timing. Failure to take the minimum required distribution by the RBD will result in a 50 percent excise tax equal to half of the amount that should have been paid out but wasn't. Although early versions of proposed legislation included a decrease in the penalty from 50 percent to 10 percent, that provision is not the law.

If you'd like more specific advice on how the new Minimum Required Distribution rules apply to your retirement strategies, please contact this office.