IRAs

Understanding Required Distributions

Questions & Answers

Why are there federal tax rules mandating required minimum distributions from a traditional IRA?

The primary purpose of a traditional IRA is to provide retirement funds for the traditional IRA accountholder and then to accumulate funds for a beneficiary. Therefore, the tax laws require an IRA accountholder to take a required minimum distribution for the year he or she attains age 70½ and each subsequent year. After the IRA accountholder dies, the beneficiary or beneficiaries will be required to take required distributions. There are specific formulas for determining how much must be withdrawn, and when. These amounts are called "required minimum distributions" (RMDs).

What happens if I fail to withdraw the required minimum distribution?

Current federal income tax law provides a penalty tax of 50% of the amount required to be distributed, but which was not. For example, if you failed to withdraw a required minimum distribution of $1,000 for a given year, then you would owe a tax of $500.

What are the tax consequences of receiving an RMD?

The general taxation rules for traditional IRAs will apply. A recipient (you or your beneficiary) will include the amount received in gross income for the year of receipt. You (or your beneficiary, if applicable) will pay taxes with respect to this amount at the marginal income tax rate which applies to you (or your beneficiary, if applicable), unless a portion of the distribution is not taxable because it is comprised of basis.

Must I withdraw all of my money because I am 70½, or may I withdraw IRA funds in a number of payments?

You are not required to withdraw all of your IRA funds in one year. You may, if you wish, but you are not required to do this. You are also permitted to set up a distribution schedule over a number of years, as long as you take each year your RMD amount or a larger amount.

As long as your money is in your IRA, it remains tax deferred, as do any earnings. By using Periodic Payments over a number of years, you spread your income out over the Payment schedule and typically will pay less tax.