THE Wealth REPORT

Some qualified retirement account owners are surprised that the IRS requires them to take a certain amount from their accounts each year. Including required minimum distributions in your financial plan can help you avoid higher taxes and potential IRS penalties.

RETIREMENT ACCOUNTS & RMDs

RMDs are crucial for retirement account owners age 72 and older

Overview

If you own a qualified retirement account and you're approaching or recently reached age 72, heads up: The IRS says you must start taking annual distributions from your account. Known as required minimum distributions, or RMDs, these withdrawals begin in the year you turn 72.

Why does this rule exist? Qualified retirement accounts are funded with pre-tax money, and the account's growth is tax-deferred. You don't pay any taxes until you start taking withdrawals from the account. The IRS uses RMDs to limit how long you can postpone paying taxes on those funds.

How RMDs Work

The RMD rule applies to traditional IRAs, SEP or SIMPLE IRAs, and employer-sponsored plans, such as 401(k)s, 403(b)s and 457(b)s. It also pertains to profit-sharing plans and other defined contribution plans. RMDs do not apply to Roth IRAs since they are funded with post-tax money.

RMDs apply to these account types:

- Traditional IRA
- SEP IRA
- SIMPLE IRAs
- 401(k)
- 403(b)
- 457(b)
- Profit-sharing plan
- Other defined contribution plan

Your total amount of RMDs will vary from year to year. The amount is calculated by taking the account balance at the end of the immediately preceding calendar year and dividing that amount by a distribution period from the "Uniform Lifetime Table" provided by the IRS.

Since withdrawals from a qualified retirement account are taxable, 100% of your RMDs are added to your taxable income for the year in which they're taken out.

Many people own more than one qualified retirement account, and RMDs are calculated separately for each account. But you have two options: You can take the total amount from either one account or split it between both accounts. Let's say your annual total RMD is $2,000. You can take the whole amount from the account of your

choosing or split it between accounts – for example, $1,000 from IRA No. 1 and $1,000 from IRA No. 2 – as long as your total RMDs add up to $2,000 for the tax year.

But be aware: Some types of retirement plans, such as 401(k)s and 457(b)s, don't allow you to aggregate your RMD. For those accounts, you must take the RMD from that account each year. Consult your advisor to find out how you should take your distributions.

Want to see how much your RMDs will be?
The IRS provides a worksheet to calculate RMDs at www.irs.gov/pub/irs-tege/uniform_rmd_wksht.pdf.

Donating Your RMDs

Since RMDs are taxable, many account owners prefer to donate their RMDs. Through a qualified charitable donation (QCD), the account owner can direct the RMD to be sent directly to a charitable organization. This approach is a win-win: The charity can use the funds to support its mission, while the account owner can take a tax deduction for the donation (if they itemize deductions).

Mark Your Calendar

The timing for your first RMD gets a little complicated. The IRS says you have until April 1 of the year *after* you turn age 72 to take your first withdrawal. So if you turned 72 on Sept. 1, 2022, you have until April 1, 2023, to request your initial RMD.

Your second and subsequent RMDs must be taken by Dec. 31 to fulfill the requirement. And don't be late: If you miss the deadline or don't take the RMDs at all, you could end up paying 50% of the RMD amount as a penalty.

If you wait until April 1 of the following year to take your RMDs, you'll be required to take two years' worth of RMDs in one year (one for the prior year when you turned 72 and one for the current calendar year when you turned 73). Taking two sets of RMDs in one year could make a big difference in your total tax bill for that year.

If you've already taken previous distributions from a qualified account in the calendar year, those withdrawals count toward your RMDs. For example, if your total RMD for the year is $10,000 and you've already taken $5,000, you need to take an additional $5,000 to meet your annual RMD.

Final Thoughts

The end of the year is approaching quickly, and Dec. 31 will be here soon! It's a good practice to start the RMD process now since it can take time for custodians to process the request.

If you turned (or will turn) 72 this year, we recommend scheduling a meeting with your financial advisor soon to review your RMDs and begin the process. And whether it's your first year or 20th year of receiving RMDs, it's also a good idea to set up recurring, systematic distributions to fulfill your RMDs. These distributions can be made monthly, quarterly or annually and sent to you by check or direct deposit. You can also request taxes be withheld from the distributions before they are sent. Not only does this make the process convenient and easy, but it reduces the chances of missing the deadline and potentially ending up with a large penalty from the IRS.

IRS. Sept. 23, 2022. "Retirement Topics – Required Minimum Distributions (RMDs)." https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds. Accessed Oct. 26, 2022.

IRS. Jan. 3, 2022. "RMD Comparison Chart (IRAs vs. Defined Contribution Plans)." https://www.irs.gov/retirement-plans/rmd-comparison-chart-iras-vs-defined-contribution-plans#:~:text=How%20should%20I%20take%20my,from%20each%20of%20your%20IRAs. Accessed Oct. 26, 2022.

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