Planning Your RMD and IRA Distributions For 2015

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We spend most of our lives saving for retirement by putting funds away in tax-advantaged ways. But many of us forget about planning the withdrawals so that they are tax advantaged as well. Although there are exceptions, retirement funds generally cannot be withdrawn until we are age 59.5. If taken out sooner there is a 10% penalty that applies in most cases (in addition there may be a state penalty).

A large number of taxpayers do not take distributions until they are forced to at age 70.5, not realizing they might benefit tax wise by taking money out sooner. For example, if you are in a low or zero tax-bracket this year, you can take a certain amount out with no or minimal tax cost. That is where planning your distributions can save a significant amount of tax dollars.

Even if you are under 59.5, if your income for the year is such that it is below the taxable income limit, you can withdraw an amount that brings you up just short of the taxable income threshold and only pay the penalty.

If you receive Social Security benefits, keep in mind that Social Security income is tax-free for lower income retirees but becomes taxable as their income increases. IRA distributions can sometimes be planned in order to minimize the taxability of the Social Security income.

Once you reach age 70.5 you are required to begin taking the prescribed minimum distributions from your Traditional IRA and other qualified pension plans. But that does not mean you can’t withdraw more than the required amount. If your income is low, it may be appropriate to take more than the minimum to save taxes in the future. Unfortunately all too many people simply take the IRS specified minimum amount without considering the tax planning aspects of the distribution.

The penalty for not taking the required minimum distribution (RMD) after reaching age 70.5 is an additional tax of 50% of the amount that should have been taken that year, based upon the RMD rules. The good news is that the IRS will generally, upon request, waive the penalty, provided that you show a corrective distribution was made in the subsequent year. So if you have missed an RMD for the prior year you should seek professional assistance right away with regard to taking corrective action.

The RMD is determined by taking the IRA balance on December 31 of the prior year and dividing that total by your remaining life expectancy from the IRS table. If you have more than one IRA, figure the RMD for each one and then combine them to get the total required distribution for the year. (An owner of a Roth IRA is not required to take distributions at any age.)

For purposes of determining the minimum distribution, all Traditional IRA accounts, including SEP-IRAs, owned by an individual are treated as one, but the actual minimum distribution can be taken from any combination of the accounts. If the owner chooses not to take the minimum distribution from each account, it is not uncommon for IRA trustees to require written certification that the owner took the minimum distribution from other accounts.

If you have other qualified plans besides Traditional IRA accounts, the RMD for those must be figured separately for each type and withdrawn from those plans and cannot be combined with the distributions from IRAs or other qualified plans to reach the RMD.

A taxpayer who fails to take a distribution in the year age 70.5 is reached can avoid a penalty by taking that distribution no later than April 1st of the following year. However, that means the IRA owner must take two distributions in the following year, one for the year in which age 70.5 is attained and one for the current year.

If an IRA owner dies after reaching age 70.5, but before April 1st of the next year, no minimum distribution is required because death occurred before the required beginning date.

Special Note: The provision allowing a direct transfer from an IRA to a qualified charity to be counted towards the RMD for the year and to be excluded from income expired at the end of 2014. However, it has been previously extended twice late in the year. Taxpayers age 70.5 and older with IRA accounts making a sizable charity donation may wish to make the donation via a direct transfer to the charity from their IRA account in case Congress extends this provision for yet another year.