OPTIMIZING REQUIRED MINIMUM DISTRIBUTIONS

Required minimum distributions take on added urgency as you approach (and reach) age 73, with specific rules and tax implications

Seventy-three is an important age milestone for those in or near retirement, as it marks the time when required minimum distributions (RMDs) begin to be withdrawn annually from Individual Retirement Accounts (IRAs) and employer-sponsored retirement plans (previously, the threshold was 72). The milestone carries with it tax consequences that are not fixed. Rather, there are a few rules to consider that can help you optimize the impact on your bottom-line.

IRAs

You must begin withdrawing from a traditional IRA by April 1 following the year in which you turn 73. The amount is based on your age with one exception: If you're married and your spouse is more than 10 years younger than you, the RMD amount is based on your joint life expectancy. If your distribution is less than the required minimum, you will be penalized 25% of the difference. NOTE: Roth IRAs do not require an RMD.

Employer-sponsored retirement plans

For employer retirement plans — 401(k)s, 403(b)s, and others — the same timeline applies as per IRAs: You must begin withdrawing from the plan by April 1 following the year in which you turn 73. However, if you are still working past 73 and you own 5% or less of a company, you may be able to delay RMDs until you retire.

Additionally, depending on your circumstances, you may receive a lump-sum distribution from 401(k), profit-sharing, and stock-purchase plans if completed in a one-year period. For tax purposes, RMDs from qualified retirement accounts are taxed as ordinary income.

Calculating your distribution

The institution where your retirement is kept typically determines the RMD amount using the formula:

Total balance as of December 31 divided by your life expectancy = distribution amount.

However, there is some leeway here that may provide you with more beneficial tax consequences:

1. You can either take your initial RMD in the year when you turn 73 or up until April 1 of the following year.
2. If you delay your RMD until the following year, you must take two RMDs that year—which may increase your tax consequences.
3. You can take your RMD as a series of withdrawals rather than one lump payment, which may help you with monthly cash flow.
4. Update your beneficiary/beneficiaries as to your distributions. For IRAs, account holders can designate anyone as a beneficiary; For employer-sponsored plans, they must designate their spouse as a beneficiary unless the spouse specifically waives the right.

Seek help

Tax consequences for RMDs can be significant and seeking the support of a financial professional can be prudent, to ensure that the results align with your goals.

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