

# A Guide to Required Distributions

As we approach year-end it is important to review and manage your required minimum distribution (RMD) spending and gifting to avoid costly penalties. Rockland Trust Investment Management Group is staffed with professionals who can help guide you through the process and make the best use of your RMDs. Contact the estate planning and/or tax professionals on our team for more information.

## What are required minimum distributions (RMDs)?

Required minimum distributions, often referred to as RMDs or minimum required distributions, are amounts that the federal government requires you to withdraw annually from traditional IRAs and employer-sponsored retirement plans after you reach age 70½ (or, in some cases, after you retire). You can always withdraw more than the minimum amount from your IRA or plan in any year, but if you withdraw less than the required minimum, you will be subject to a federal penalty.

The RMD rules are designed to spread out the distribution of your entire interest in an IRA or plan account over your lifetime. The purpose of the RMD rules is to ensure that people don't just accumulate retirement accounts, defer taxation, and leave these retirement funds as an inheritance. Instead, required minimum distributions generally have the effect of producing taxable income during your lifetime.

## Which retirement savings vehicles are subject to the RMD rules?

In addition to traditional IRAs, simplified employee pension (SEP) IRAs and SIMPLE IRAs are subject to the RMD rules. Roth IRAs, however, are not subject to these rules while you are alive. Although you are not required to take any distributions from your Roth IRAs during your lifetime, your beneficiary will generally be required to take distributions from the Roth IRA after your death. Employer-sponsored retirement plans that are subject to the RMD rules include qualified pension plans, qualified stock bonus plans, qualified profit-sharing plans, including 401(k) plans. Section 457(b) plans and Section 403(b) plans are also subject to these rules. If you are uncertain whether the RMD rules apply to your employer-sponsored plan, you should consult your plan administrator or a tax professional.

## When must RMDs be taken?

Your first required distribution from an IRA or retirement plan is for the year you reach age 70½. However, you have some flexibility as to when you actually have to take this first-year distribution. You can take it during the year you reach age 70½, or you can delay it until April 1 of the following year.

Since this first distribution generally must be taken no later than April 1 following the year you reach age 70½, this April 1 date is known as your required beginning date. **Required distributions for subsequent years must be taken no later than December 31 of each calendar year until you die or your balance is reduced to zero.** This means that if you opt to delay your first distribution until April 1 of the following year, you will be required to take two distributions during that year — your first year's required distribution and your second year's required distribution.

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### How are RMDs calculated?

RMDs are calculated by dividing your traditional IRA or retirement plan account balance by a life expectancy factor specified in IRS tables. Your account balance is usually calculated as of December 31 of the year preceding the calendar year for which the distribution is required to be made.

**Caution:** When calculating the RMD amount for your second distribution year, you base the calculation on the IRA or plan balance as of December 31 of the first distribution year (the year you reached age 70½) regardless of whether or not you waited until April 1 of the following year to take your first required distribution.

### Should you delay your first RMD?

Your first decision is when to take your first RMD. Remember, you have the option of delaying your first distribution until April 1 following the calendar year in which you reach age 70½ (or April 1 following the calendar year in which you retire, in some cases).

You might delay taking your first distribution if you expect to be in a lower income tax bracket in the following year, perhaps because you're no longer working or will have less income from other sources. However, if you wait until the following year to take your first distribution, your second distribution must be made on or by December 31 of that same year.

Receiving your first and second RMDs in the same year may not be in your best interest. Since this "double" distribution will increase your taxable income for the year, it will probably cause you to pay more in federal and state income taxes. It could even push you into a higher federal income tax bracket for the year. In addition, the increased income may cause you to lose the benefit of certain tax exemptions and deductions that might otherwise be available to you. So the decision of whether to delay your first required distribution can be important, and should be based on your personal tax situation.

### What if you fail to take RMDs as required?

You can always withdraw more than you are required to from your IRAs and retirement plans. However, if you fail to take at least the RMD for any year (or if you take it too late), you will be subject to a federal penalty. The penalty is a 50% excise tax on the amount by which the RMD exceeds the distributions actually made to you during the taxable year.

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### Can you satisfy the RMD rules with the purchase of an annuity contract?

Your purchase of an annuity contract with the funds in your IRA or retirement plan satisfies the RMD rules if all of the following are true:

- Payments are made at least yearly
- The annuity is purchased on or before the date that distributions are required to begin
- The annuity is calculated and paid over a time period that does not exceed those permitted under the RMD rules
- Payments, with certain exceptions, are non-increasing

You may also be able to use up to 25% of your non-Roth IRA and retirement plan account balances (up to a maximum of \$130,000 from all accounts, indexed for inflation) to purchase a qualifying longevity annuity contract (or QLAC). The value of the QLAC is disregarded when you calculate the amount of RMDs you are otherwise required to take from your account each year. Payments from the QLAC can be delayed up to age 85, and are treated as satisfying the RMD rules when paid. The rules can be complicated, and QLACs are not right for everyone, so be sure to consult a qualified professional for further information. (Note: Any annuity guarantees are subject to the claims-paying ability and financial strength of the annuity issuer.)

## TAX CONSIDERATIONS

### Income tax

Like all distributions from traditional IRAs and retirement plans, RMDs are generally subject to federal (and possibly state) income tax for the year in which you receive the distribution. However, a portion of the funds distributed to you may not be subject to tax if you have ever made after-tax contributions to your IRA or plan.

For example, if some of your traditional IRA contributions were not tax deductible, those contribution amounts will be income tax free when you withdraw them from the IRA. This is simply because those dollars were already taxed once. You should consult a tax professional if your IRA or plan contains any after-tax contributions. [Special tax rules apply to Roth IRAs and Roth 401(k)/403(b) contributions.]

**Caution:** Taxable income from an IRA or retirement plan is taxed at ordinary income tax rates even if the funds represent long-term capital gain or qualifying dividends from stock held within the plan. There are special rules for capital gain treatment in some cases on distributions from retirement plans.

### Gift and estate tax

You first need to determine whether or not the federal gift and estate tax will apply to you. If you do not expect the value of your taxable estate to exceed the applicable exclusion amount, then federal gift and estate tax may not be a concern for you. However, state death (or inheritance) tax may be a concern. In some cases, your assets may be subject to more than one type of transfer tax — for example, the generation-skipping transfer tax may also apply. Consider getting professional advice to establish appropriate strategies to minimize your future gift and estate tax liability.

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For example, you might reduce the value of your estate by gifting all or part of your required distribution to your spouse or others. Making gifts to your spouse can sometimes work well if your estate is larger than your spouse's, and one or both of you will leave an estate larger than the applicable exclusion amount. This strategy can provide your spouse with additional assets to better utilize his or her applicable exclusion amount, thereby minimizing the combined gift and estate tax liabilities of you and your spouse. Be sure to consult an estate planning attorney, however, about this and other possible strategies.

**Caution:** In addition to federal gift and estate tax, your state may impose its own estate or death tax (or other transfer taxes).

### Inherited IRAs and retirement plans

Your RMDs from your IRA or plan will cease after your death, but your designated beneficiary (or beneficiaries) will then typically be required to take minimum required distributions from the account. A spouse beneficiary may generally roll over an inherited IRA or plan account into an IRA in the spouse's own name, allowing the spouse to delay taking additional required distributions until he or she turns 70½.

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