PacificCPE

COURSE
33453A

Required Minimum Distributions: Rules and Compliance

Required minimum distributions are one of the most common—and consequential—areas of retirement plan compliance. This course walks through the RMD rules, including when distributions must begin, how to calculate them, and the consequences of missing a required distribution. Coverage includes lifetime distribution rules, annuity options, and the regulatory framework under the tax code. Whether you're helping clients avoid costly penalties or correcting past failures, this course gives you the practical grounding needed to handle RMD questions with confidence.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify the age at which required distributions must commence.
- Recall which types of retirement accounts permit aggregation.

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Chapter 1: REQUIRED DISTRIBUTIONS: TAKING MONEY OUT WHEN YOU HAVE TO

Chapter Objective

After completing this chapter, you should be able to:

- Identify the age at which required distributions must commence.

Someone once said that the government's strategy for encouraging people to use their retirement money is a lot like herding cattle through a gate. If a cow heads off to the left of the gate, a cattle prod nudges her back on track. Similarly, if you wander off the retirement trail and withdraw your funds too early, you're brought up short with an early distribution tax. If our proverbial cow meanders too far to the right, she receives another painful poke, just like you're hit with another penalty if you wait too long to withdraw your retirement money. That penalty—for waiting too long—is the focus of this chapter.

To avoid being penalized for delaying distributions, you must comply with what are called the "required distribution rules." Those rules mandate that you take a minimum amount—your "required minimum distribution," or RMD—from your retirement plan when you reach a certain age. That age is 72 if you were born in 1950 or earlier. For those born between 1950 and 1960, the age is 73. And for those born in 1960 or later, the age is 75.

Under certain circumstances, you can delay required distributions if you work past the typical RMD age. (See "Your RMD Age," below.)

The amount of your required minimum distribution is calculated according to a formula in the income tax regulations. You can take more than the minimum, but you can't take less. If you do take less, you'll be fined a percentage of the amount that should have come out of your plan but didn't (the "shortfall," in penalty parlance).

The required distribution rules evolved from Congress's desire that you use up your retirement funds during your own retirement, instead of passing the assets on to your heirs. The rules present you with a date by which you must start withdrawing money from your retirement plan. They also answer questions such as: What happens if you die before the date you're supposed to begin distributions? Does the law provide income tax relief to your heirs? Is your beneficiary allowed to defer taking distributions from your plan even though the funds were never intended for their retirement? Does your spouse have special privileges?

As if those issues didn't complicate matters enough, there's a flip side to the premature death issue: What happens if you die after you've started receiving required distributions but before you've used up all your retirement money? Does this change anything? Are your heirs given relief in this situation? And, again, does your spouse have special privileges?

The required distribution rules attempt to address all of these questions and more. In this chapter, we offer a summary of these rules.

Helpful Terms

403(b) plan. See TDA, or tax-deferred annuity, below.

Beneficiary. The person or entity entitled to receive the benefits from insurance or from trust property, such as a retirement plan or an IRA, usually after the insured or the owner of the property dies.

Deferral period. The number of years over which distributions from a retirement plan or an IRA can be spread.

Distribution. A payout of property (such as shares of stock) or cash from a retirement plan or an IRA to the participant or a beneficiary.

Eligible designated beneficiary. One of the following individuals: a spouse, a minor child (until the child reaches age 21, the age of majority), an individual who isn't more than 10 years younger than the participant, or a disabled or chronically ill individual.

Grandfather provision. A part of a new law that exempts an individual or entity from the new law and allows the individual or entity to use the old law or special transitional laws.

RMD, or required minimum distribution. The minimum you must take out of your retirement plan when you reach a certain age or when you inherit retirement assets.

TDA, or tax-deferred annuity (also known as a tax-sheltered annuity). Many university professors, public school employees, and employees of nonprofit organizations are covered by TDAs, which are retirement annuity plans for public charities or public schools. These retirement plans are usually funded with individual annuity contracts purchased from insurance companies. Retirement benefits are frequently paid as a monthly annuity for life.

Waiver. Intentional dismissal, as of a penalty.

YOUR RMD AGE

Your RMD age (known as your "applicable age" in the tax code) is the year you have to start taking required minimum distributions. Your RMD age is determined by the year you were born:

- If you were born in 1950 or earlier, you generally had to begin RMDs when you reached age 72.
- If you were born between 1950 and 1960, your RMD age is 73.
- If you were born in 1960 or later, your RMD age is 75.

For purposes of the discussion and examples in this chapter, we will assume you were born after 1950.

LIFE EXPECTANCY TABLES

The IRS publishes three life expectancy tables that can be used to calculate required distributions. As we explain the methods for calculating required distributions in the sections below, we'll be discussing these three tables:

- A single life expectancy table (called the "Single Life Table" or "Single Life Expectancy Table")
- A joint expectancy table (called the "Joint Life and Last Survivor Table" or "Joint Life and Last Survivor Expectancy Table"), and
- The "Uniform Lifetime Table."

Each table will give you different required distribution amounts because each table uses different life expectancies. The Uniform Lifetime Table is generally used by married owners whose spouses aren't more than 10 years younger, married owners whose spouses aren't the sole beneficiaries, and unmarried plan owners calculating their own withdrawals. The Single Life Table is used when a beneficiary isn't the spouse of the plan owner. And the Joint Life and Last Survivor Table is used when the sole beneficiary is a spouse who is more than 10 years younger than the plan owner. We'll go into detail below, and in Chapter 1 of course 33451G of course 33454G, Chapter 1 of course 33451G of course 33455G, about when each table can be used.

In 2022, the IRS updated these life expectancy tables for the first time in many years. You can find the old life expectancy tables (for years 2021 and earlier) in Appendix B of this book and the new life expectancy tables (for years 2022 and later) in Appendix C.

The new life expectancy tables are optional for 2022 and earlier. Here are the rules on when you need to use the new tables.

- If you began taking required minimum distributions in 2021 or earlier, you used the tables in Appendix B. You can continue to use the old tables, or you can make a one-time switch to the new tables in Appendix C.
- If you began taking distributions in 2022, you were permitted to use either the old or the new tables. If you chose the old tables, you can stick with them or you can make a one-time switch to the new tables.

- If you began taking distributions in 2023 or later, you're required to use the new tables (in Appendix C), if you want the "safe harbor" rules to apply to you (see Chapter 2 of course 33452G for a discussion of safe harbor rules).

REQUIRED DISTRIBUTIONS DURING YOUR LIFETIME

You don't have to worry about taking required distributions from your own retirement plan until the year you reach your RMD age.

When you reach your RMD age, you must start taking distributions under one of the following two scenarios:

- You can withdraw everything by your "required beginning date," or RBD, which for most people is April 1 of the year after turning 73, but for some people will be April 1 of the year after they retire. (See Chapter 2 for more information about determining your RBD.)
- Alternatively, you can take distributions from your retirement plan over a period of years. Most people will use the Uniform Lifetime Table (see Table III in Appendix B or C) to determine the number of years over which they can spread distributions. If your spouse is your beneficiary and is more than 10 years younger than you are, however, you will use a different and more favorable table called the Joint Life and Last Survivor Table. (See Table II in Appendix B or C.)

Caution!

Use new life expectancy tables for years 2022 and beyond. The IRS has updated the life expectancy tables. When calculating required distributions for 2021 and earlier, you should use the life expectancy tables found in Appendix B. For all years after 2021, you should use the life expectancy tables found in Appendix C.

When faced with those two distribution options, few people would choose the first—to distribute the entire amount of their retirement plan at once—because of the income tax implications. A large distribution all in one year could put you in a higher tax bracket for that year, allowing the government to take a huge tax bite out of your nest egg.

In contrast, the second option allows people to spread distributions over a period of years, thereby keeping their tax burden lower. As an added bonus, the second option is flexible: If people want to take only the minimum required amount in one or more years, they can, but they also have the option of taking more money out when they need it.

Chapter 2 describes the steps involved in determining your required distributions during your lifetime.

REQUIRED DISTRIBUTIONS BY A BENEFICIARY

The required minimum distribution rules for your beneficiaries vary depending on whether you die before or after your RBD (your required beginning date). We'll discuss these differences below.

First, understand that many beneficiaries need to take distributions from their retirement plan over no more than 10 years (because of what's called the "10-year rule"). But the required distribution rules differ if your death occurs before your RBD instead of after your RBD. We'll discuss the differences below.

An exception to the 10-year rule applies to certain "eligible designated beneficiaries," who are permitted to spread distributions over their life expectancy. Eligible designated beneficiaries include:

- Your spouse
- Your minor child, whether the child is your biological child, adopted child, stepchild, or eligible foster child (until the child reaches age 21, the age of majority)
- An individual who isn't more than 10 years younger than you
- A disabled individual, or
- A chronically ill beneficiary.

An eligible foster child is one who is placed with the family by an authorized placement agency or by judgment, decree, or other court order.

Tip

Defined benefit plans that are paid out as an annuity are another exception to the 10-year rule. If your defined benefit plan allows, annuity payments from the plan can be distributed over the life expectancy of your beneficiary.

Caution!

A lump-sum distribution or rollover from your defined benefit plan will void the exception to the 10-year rule. If you roll over your entire defined benefit plan into an IRA when you retire, the assets will then be subject to the IRA rules. Specifically, when you die, the 10-year rule will apply unless your beneficiary of your IRA is an eligible designated beneficiary.

Tip

Some beneficiaries are grandfathered under the old rules. The 10-year rule applies only to retirement plan participants who die after December 31, 2019. Designated beneficiaries of plan participants who died before December 31, 2019 who chose to take distributions over their own life expectancy can generally continue to do so. (However, those beneficiaries must begin using the new life expectancy tables beginning in 2022. The switch to the new tables involves a special one-time transition calculation. See Chapter 2 for more information.) Note that, when the grandfathered designated beneficiary dies, if the account has not been fully distributed, the successor beneficiary will be subject to the 10-year rule.

DEATH BEFORE REQUIRED BEGINNING DATE

If you die before your RBD, any noneligible designated beneficiaries (those who aren't eligible designated beneficiaries) need to take all distributions from your retirement plan over no more than 10 years. However, these beneficiaries can take those distributions in any way they choose, whether spread out in monthly installments over 10 years or in one lump sum at the end of the 10-year period. The 10-year period ends on December 31 of the year containing the tenth anniversary of your death.

Tip

Here's a planning strategy to boost your retirement savings. If you need to withdraw money from an inherited account (either over your lifetime or within 10 years) to satisfy RMD rules, you can simply increase your own retirement plan contribution by the amount you need to withdraw from the inherited account each year (until you reach the annual maximum contribution limit for your retirement plan). The taxes you pay on the inherited account distribution can be offset by the tax savings from deferring more funds into your own plan.

Five-Year Rule

If you haven't named a beneficiary, or if your beneficiary isn't an individual, your retirement plan assets will be subject to a five-year rule. The five-year rule is identical to the 10-year rule—just shorter. In other words, under the five-year rule, your retirement plan assets must be completely distributed by December 31 of the year containing the fifth anniversary of your death. And again, the law doesn't require that a particular distribution method be used. For example, the funds can be distributed incrementally over that five-year period or in one lump sum at the end of the period.

Transferring Assets to a New IRA

If your beneficiary is someone other than your spouse, upon your death, your beneficiary will have the option to transfer your retirement plan assets into a new inherited IRA and spread distributions over 10 years (or in the case of an eligible designated beneficiary, over their own life expectancy). However, the new inherited IRA must be titled in your name, as the original owner, and distributions to eligible designated beneficiaries must begin in the year after your death.

Your nonspouse beneficiaries will also have the option to transfer your retirement plan assets to a new inherited Roth IRA titled in your name. This is called a "conversion." If your beneficiaries choose this option, they must first pay taxes on the converted amounts and must take distributions over no more than 10 years, or if they're eligible designated beneficiaries, over their life expectancy, beginning in the year after your death. Note that this strategy works only for conversions from an inherited retirement plan (like a 401(k) plan) to an inherited Roth IRA. (Beneficiaries can't convert inherited traditional IRAs to Roth IRAs.)

Special Privileges for Your Spouse

If your beneficiary is your spouse, some additional privileges are available. After your death, your spouse can defer distributions from your retirement plan until the year you would have reached your RMD age. If your spouse is the sole beneficiary, they can keep the plan as an inherited account (meaning it remains in your name) and spread the distributions over their own life expectancy using the Uniform Lifetime Table (Table III in Appendix C). This is possible because the IRS will assume your spouse is making the "spousal election" to treat the inherited plan as their own (as if they were you). Without this election, your spouse would have needed to use the Single Life Table (Table I).

Tip

Automatic spousal election. Proposed IRS regulations state that the spousal election is automatic when a plan holder dies before their RBD (required beginning date).

Alternatively, your spouse can roll over your retirement plan (whether a qualified plan or an IRA) to an IRA or plan of their own. Your spouse would then name new beneficiaries and begin required distributions in the year they turn 73. If your spouse rolls the plan into a Roth IRA, taxes will be due in the year of the rollover, but no distributions will be required during your spouse's lifetime.

Caution!

If there are multiple beneficiaries. If your spouse isn't the sole beneficiary but is instead one of several, then your spouse might lose some of these special privileges.