Motley Fool’s *Rule Your Retirement* Newsletter

The Ins and Outs of Retirement Accounts

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July 28, 2016

Uncle Sam thinks he's been kind to you, allowing you to contribute money to retirement accounts that grow year after year without him taking a slice. Heck, he may have even given you a tax break on the money you contributed, just to encourage you to save for your future.

But as you reach your 70s, Uncle Sam starts getting persnickety about whether you can continue contributing to these accounts, and if you must start taking money out. And in true governmental fashion, the restrictions and requirements aren't easy to keep straight. Each type of account -- whether it be a 401(k), 403(b), or a traditional or Roth IRA -- has its own rules.

Not heeding those rules can be a headache ... or worse. Contributing to an account you weren't supposed to can be a paperwork nightmare, as well as resulting in taxes and penalties. Then there are required minimum distributions (RMDs) for investors who've reached their 70s or who inherited a retirement account at any age. Any amount that should have been withdrawn but wasn't can be subject to a 50% penalty. That's one of the stiffest penalties imposed by the IRS.

Here's what you need to know about each type of retirement account to get the most tax-advantaged growth and avoid unnecessarily handing over some of that growth to Uncle Sam.

Traditional IRAs

Contributions: Anyone who earns income through work and isn't yet age 70 1/2 can contribute. But once you reach 70 1/2, you can no longer contribute, even if you're still working. Contributions are tax-deductible if you're not covered by a retirement plan at work. If you are, the amount you can deduct gradually phases out between modified adjusted incomes of $61,000 to $71,000 if you're single or $98,000 to $118,000 if you're married and file a joint return in 2016.
RMDs: You must take your first RMD by April 1 of the year *after* you turn 70 1/2. But if you wait until then, you'll have to take two distributions that year, one by April 1 and another by Dec. 31. Every year thereafter, the RMD must be withdrawn by Dec. 31. If you have multiple traditional IRAs (including SEP IRAs and SIMPLE IRAs), you must calculate an RMD for each, but the total amount can be withdrawn from just one account.

What does the IRS consider the day you turn 70 1/2? It's six calendar months after your 70th birthday. For example, if your 70th birthday was on June 30, 2016, then you'd reach 70 1/2 on Dec. 30, 2016. You must take your first RMD (for 2016) by April 1, 2017. If your birthday was just one day later -- on July 1, 2016 -- you'd reach 70 1/2 on Jan. 1, 2017. You wouldn't need to take an RMD for 2016.

Roth IRAs

Contributions: There are no age restrictions on contributing to a Roth IRA, but the amount you can contribute gradually decreases from a maximum of $5,500 ($6,500 if you're 50 or older) once you reach a modified adjusted gross income of $117,000 for singles and $184,000 if married filing jointly; it hits zero at modified adjusted gross incomes of $132,000 for singles and $194,000 for married folks filing joint tax returns in 2016.
RMDs: None! You can leave the money in the account forever or until you die, whichever comes first.

401(k)s and 403(b)s

Contributions: As long as you're working, you can contribute to your employer's plan, even if you're over 70 1/2. If your employer offers a Roth option, you can contribute regardless of your income.
RMDs: No required distributions from your employer's plan if you're still working, as long as you don't own 5% or more of the company. You should take your first RMD by April 1 of the year after you retire; you will then have to take another RMD by Dec. 31 of that year. This ability to delay RMDs well beyond 70 1/2 if you're still working applies *only* to your current employer's plan; accounts with past employers are governed by *most* of the same RMD rules as traditional IRAs. This includes Roth 401(k)s and Roth 403(b)s, which are subject to RMDS -- but you can get around them by rolling the money over to a Roth IRA. (Note: Rolling over accounts with former employers into IRAs has all kinds of other benefits, including potentially lower costs and more investment choices.)

If you have multiple 401(k)s with former employers, each RMD must be taken from each individual account. The total value of RMDs from multiple 403(b)s, however, can be taken from just one account; also, money contributed to a 403(b) before 1987 doesn't have to be distributed until age 75 if those amounts have been accounted for with separate records.

SEPs and SIMPLE IRAs

Contributions: Like other employer-sponsored accounts, you can make contributions as long as you're working for the company that sponsors the plan, regardless of your age.
RMDs: Because SEPs and SIMPLEs are technically IRAs, they follow the IRA RMD rules. This means that the account holder must take RMDs at age 70 1/2, even if the person is still working for the company sponsoring the plan. This could result in a situation where a 70-something employee contributes to the plan while also having to take required distributions.

Inherited Accounts

Contributions: Generally, you can't contribute to an account you inherit. The exception is an account owned by the spouse of the deceased, if that spouse retitles the account in her or his own name.
RMDs: The rules can get complicated, depending on whether you were the spouse of the deceased and whether the deceased was in the process of taking required minimum distributions before he or she died. But generally, beneficiaries of inherited retirement accounts have three options:

1. **Transfer the assets to their own IRA:** This option is only available to the spouse of the deceased. Once the assets are in the spouse's account, RMDs and early withdrawal penalties (if any) will be determined by the spouse's age.
2. **Empty the account within five years:** No withdrawals are required in any given year as long as all the assets are distributed within five years of the benefactor's death. The distributions will be exempt from the 10% early withdrawal penalty normally applied to distributions made before age 59 1/2.
3. **Stretch the account over the beneficiary's lifetime:** Take RMDs each and every year, starting the year after the benefactor's death. While this option would require the beneficiary to begin taking money sooner than the five-year option, the rest of the account can be left to grow for decades. But it does mean that any beneficiary, of any age, must take an annual RMD. Even a 1-year-old baby who inherited an IRA from her grandmother would need to take a required distribution each year the account has money in it. This would be the case even if it's a Roth IRA. Fortunately, these RMDs are also exempt from the 10% early withdrawal penalty.

Note that the third option is available only to named beneficiaries of an account. If the account didn't have named beneficiaries, or they had already passed away, the account then goes into the overall estate. Anyone who then inherits the account must liquidate it within five years, which could result in a large tax bill and the loss of future tax-advantaged growth; the option to "stretch" the account over a beneficiary's life has been lost. This is why it's important to name specific people as the primary and backup beneficiaries of your retirement accounts, and to keep that information updated.

How to Calculate RMDs

To calculate your RMD, divide the value of each account as of Dec. 31 of the previous year by your "distribution period," which will depend on your age, your spouse's age, and who you name as the beneficiaries of your accounts when that Great Tax Collector in the Sky mandates your required mortality distribution.

The financial-services company that has your account will likely send you a notice with your RMD already calculated, and can provide the number over the phone. You can also get an estimate using an online RMD calculator like this one. Or you can use resources provided by the IRS:

- RMD worksheet if your spouse is the sole beneficiary of your account, and you are more than 10 years older than him or her
- RMD worksheet for everyone else over age 70 ½
- Chart that explains how to calculate RMDs for beneficiaries of inherited accounts

RMD Odds and Ends

Credit denied. If you withdraw more than the minimum in one year, you can't use that fact to reduce the RMD in the next year (However, it will have that effect to some degree because you've reduced the size of the account.)

A Roth conversion doesn't count, but ... Your RMD must exit your retirement account and land in a regular, taxable account. You can't satisfy an RMD by converting that amount from a traditional account to a Roth account. However, Roth conversions do have the effect of reducing future RMDs, because they reduce the value of traditional tax-deferred accounts (which are subject to RMDs) and increase the amount you have in Roth IRAs (which are *not*subject to RMDs).

Take your RMD in investments. While you can contribute only cash to a retirement account, there are no rules against distributions being made in shares of stock, shares of funds, individual bonds, or whatever other investments you hold in your account. So if you don't need the proceeds of your RMD to pay for living expenses, and you like the investments you hold, ask your account provider about doing a so-called "in-kind distribution." You'll still owe applicable taxes on the value of the distribution.

Make your requirement altruistic. Each taxpayer can contribute up to $100,000 a year directly from a retirement account to a qualified charity, and the contribution will count toward that person's RMD. The benefit to you – besides the good karma – is that you won't owe taxes on the amount of the distribution that goes to the charity. Known as a qualified charitable distribution (QCD), for years this provision was something Congress had to approve annually, and they often did it too late in the year to be useful. But thanks to a law passed in 2015, the QCD is now a permanent part of the tax code.

Ask the IRS for forgiveness. If you didn't withdraw your RMD on time and are facing that stiff 50% penalty, you can seek a waiver from the IRS by filing Form 5329 and attaching a letter of explanation.

RMD after R.I.P. Yes, Uncle Sam might require a minimum distribution even after the account owner has died. The rules are unbelievably complicated, so if you are settling an estate or have inherited an IRA, do additional research or hire a tax pro.

January 1 is the big day. Your marital status affects your RMDs. As far as the IRS is concerned, if you're married on January 1, you're married the whole year, regardless of a death or divorce that occurs on any of the other 364 days.