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# Everything You Need to Know About Required 401(k) and IRA Withdrawals

Required minimum distributions can be confusing. Here are smart ways to go about it.

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If you are one of the millions of Americans with a retirement-savings account, three of the most important letters in your financial life might be these:

## RMD.

They stand for required minimum distribution, which is something that the nation's baby boomers now need to grapple with for the first time. It refers to an annual payout that savers must take from their retirement kitty at a certain point, as required by law.

The first of the boomers (people born mid-1946 through 1964) are just now hitting the age of 70½, when most will be required to pull money out of their 401(k)s and IRAs, but there are a dizzying array of exceptions and deadlines regarding these payouts. For example, some people who are still working at age 70½ *don't* have to start taking RMDs from a 401(k).

"I was surprised at how complicated the process was for me—and I'm an expert," says Natalie Choate, a lawyer with Nutter, McClennen & Fish in Boston who turned 70½ last year.

Here are questions savers are asking about withdrawal requirements, with answers that draw on the expertise of Ms. Choate and another IRA specialist, CPA Ed Slott of Rockville Centre, N.Y.

**Why is age 70½ important?**

It marks the point when savers must begin taking required annual payouts from tax-sheltered retirement accounts such as individual retirement accounts, Simple IRAs and SEP IRAs. Such payouts are often required for 401(k), 403(b) and other workplace plans as well.

**Why are withdrawals required?**

Congress encouraged people to save for retirement by providing tax benefits for these accounts, but lawmakers don't want to shelter these savings forever. So users often must withdraw at least a minimum amount every year after age 70½.

**Do all retirement accounts have mandatory withdrawals after 70½?**

Most, but not all. Under current law, there are no required withdrawals from Roth IRAs during the owner's lifetime. Roth IRAs are different from many other tax-sheltered retirement accounts in that savers pay tax on the money they contribute. Then the assets can grow tax-free and be withdrawn tax-free.

There's also a useful exception for employees who participate in workplace plans such as 401(k)s and are still working after age 70½. If these workers don't own more than 5% of the company and their plan doesn't mandate payouts at 70½, then they needn't take required withdrawals from the plan until they retire.

In addition, if this plan accepts rollovers of the worker's other IRAs or other 401(k)s, then those assets can typically be shielded from required payouts as well, until the worker retires. Otherwise, those accounts will have required withdrawals after 70½.

**How large are mandatory withdrawals?**

For most people they begin at about 3.6% of assets and rise with age—although they're never large enough to empty the account. The withdrawal percentage is lower for savers whose spouse is more than 10 years younger and is the sole beneficiary of the IRA.

The annual percentage applies to an individual's retirement assets as of the preceding Dec. 31. In other words, a required withdrawal for 2017 is based on assets as of Dec. 31, 2016. There's no limit on withdrawals—for example, an IRA owner can pull out as much above the RMD amount as he or she wants.

**How do I figure the minimum withdrawal?**

IRA sponsors are required to compute this amount for savers, but they can make mistakes.

If you want to double-check, the Internal Revenue Service gives tables for making the calculation in Appendix B to Publication 590-B. In essence, savers take their relevant retirement assets and divide it by a life-expectancy factor—which changes slightly every year.

For example, say a 72-year-old single woman had $400,000 of IRA assets on Dec. 31, 2016. According to Table III, her factor is 25.6 years. So she divides $400,000 by 25.6 and learns that she must withdraw at least $15,625 in 2017.

**What's the deadline for taking required withdrawals?**

The first payout is for the year a taxpayer turns 70½. This can be tricky, so we'll use two presidents as an example. For someone like Donald Trump who was born during first half of 1946, the first withdrawal must be taken for 2016. But for someone like Bill Clinton born in the second half of 1946, the first payout is due for 2017.

For most years, the deadline for taking the mandatory withdrawal is Dec. 31. But there's a grace period for the first payout, and the deadline is April 1 of the following year. Thus, someone born in the first half of 1946 must take the first payout by April 1, 2017, but for someone born in the last half of 1946, the initial deadline is April 1, 2018.

Caveat: Savers who postpone their first withdrawal until the April 1 deadline risk triggering a higher tax bracket, because they will have two payouts in the same year.

**What's the tax rate on withdrawals?**

The withdrawal becomes part of the saver's ordinary income and is taxed at those rates, not lower long-term capital-gains rates.

If the saver has after-tax money in a traditional IRA, then a portion of the required annual payout is not taxable. Figuring this portion can be troublesome and requires good records.

**I have several IRAs and a 401(k) plan with required withdrawals. Must the payout for each account come from that account?**

This issue causes much confusion. Each payout from a 401(k) plan must be figured separately and taken from that account.

With IRAs, however, the saver is free to take the required payout disproportionately. So he or she can take a large amount from one IRA, a little from another and nothing from others, as long as payments add up to the correct total. A good reason to take uneven payouts might be that one account has more cash than another, or the owner wants to drain a smaller IRA and close it.

But be sure to avoid another common mistake in this area, which is when one spouse takes the entire required payout for both spouses if each has IRAs. Instead, each partner must take such payouts from his or her own accounts.

**Must I take withdrawals in cash?**
No, it’s possible to take them “in kind”—that is, as stock shares or even a piece of real estate. For an IRA owner who doesn’t plan to spend the money, this move could help avoid commissions for selling and then repurchasing an investment. But it can be complicated, so allow extra time and find out if the sponsor charges fees.

The new “cost basis” in the asset, which is the starting point for measuring taxable gain, is the value on the date of the payout.

**How should I time withdrawals?**
This is a matter of individual choice. Some savers opt for periodic payments similar to a pension. Others take a lump sum late in the year to delay owing taxes. Retirees often owe quarterly estimated taxes, so consider whether to have taxes withheld.

If a saver dies without having taken the required payout for the year, there can be complications for the person or people who inherit the IRAs. There’s still a required withdrawal, but it goes on the heir’s tax return.

**If I take more than the minimum payout one year, can I apply the excess to my minimum payout the next year?**
No.

**Required withdrawals are showering me with taxable income I don't need. Are there ways to lower them?**
Yes, within limits. Still-working employees older than 70½ may be able to forgo payouts until they retire (see discussion above).

In addition, charitably minded savers often benefit by using IRA assets to make their donations (see related article).
IRA owners can also exclude up to $125,000 of assets from the base for computing required payouts if they use the assets to buy "qualifying longevity annuity contracts," or QLACs. These are IRS-approved deferred annuities that don't pay out until the owner reaches age 85, and they help make sure savers won't outlive their assets.
Finally, the IRA owner can convert IRA assets above the required annual payout to a Roth IRA, which doesn't require withdrawals during the owner's lifetime under current law.

The catch here is the cost: Assets converted to a Roth IRA are taxable, and doing a conversion can push the taxpayer into higher brackets. Whether the move is worth it depends on individual circumstances.

Many people who convert assets to Roth IRAs do so in increments over several years in order minimize the tax bill. Often a good time to do such conversions is in the years leading up to age 70½. If the IRA owner has retired and is in a lower tax bracket, the cost of Roth conversions will often be lower as well.

**What if I miss a withdrawal or take less than the required amount?**
The penalty is 50% of the amount not withdrawn. That's stiff, but there's often a remedy, says Mr. Slott. Just withdraw the shortfall right away, file Form 5329 with the IRS, and attach a short statement explaining why. You don't need to pay the penalty to do this.

Often the IRS will forgive the penalty, he says, and filing the form also starts the clock running for the statute of limitations. “I’ve seen this work in virtually every case,” he says.