

Understanding Required Minimum Distributions

[A COMPREHENSIVE GUIDE]

Like many of our clients, you probably have an IRA. And there's a real good chance that it is the largest financial asset you own. Yet we've found that when we meet with clients for the first time, they have a lot of questions on what the IRS will make them do with their IRA ... especially when it comes to Required Minimum Distributions (RMD).

And that's why we've put together this guide of the most frequently asked questions ... so that you'll have a better idea of what's in store for you and your loved ones.



Frequently Asked Questions

Q. How much income tax do I have to pay on my RMD?

- A. *If you take money out of your IRA, it's taxable at your maximum tax rate ... the lower capital gains rate doesn't apply. So, that's as much as 35% for the IRS. And don't forget that your State might want something, too.*

Q. Do all States have the same tax laws on RMD?

- A. *That would be too simple. RMD's receive different tax treatment in different States. These differences could present opportunities for you to manage your tax bill and cash flow more efficiently.*

Here are a few of the variations among State tax laws:

States Where All Income Is Tax-Free

In Florida, Texas, Nevada, and other States where there are no state income taxes, residents can keep a greater share of their IRA distributions. Therefore, if you're thinking about relocating to the Sunshine State from a State such as New York, which assesses income taxes on IRA withdrawals, you might consider moving before you have to start your RMD. That way, you can avoid any State income taxes on the distributions in New York.

States Where IRA Withdrawals Are Tax-Free

Certain States (New Jersey, for example) don't allow taxpayers to deduct IRA contributions from their taxable income on their State tax return. But later on when those contributions come out of the IRA, residents of these States typically don't have to worry about paying State income taxes on the withdrawals.

Q. Suppose I don't take anything out? No tax, right?

- A. *Yes. But, you cannot keep money in your IRA indefinitely. There comes a day of reckoning. And you must begin removing money by April 1 of the year following the year you turn 70½. This means that if, for example, you turned 70½ at any time this year, your first payment is due by April 1 next year. You may be better off paying it this year. If you wait, you'll have to take two taxable distributions next year: the first by April 1 and the second by December 31.*



Frequently Asked Questions



**Q. Why does the government make me take out money?
Can't they just wait for me to die?**

A. The IRS established the RMD rules so they'd have a better chance of getting the tax on the account while you are alive ... sooner rather than later.

Q. Is there ever a reason to begin my RMD before I'm 70½?

A. Yes. You might be better off taking money out a few years earlier to use up your current tax bracket. Higher RMD's after you turn 70½ could bump all of your income into a higher bracket. We can help you with those calculations.

Q. How much do I have to take out?

A. The IRS has a set of worksheets that you can struggle through, however, we can figure it out for you at no cost or obligation.

Here's part of how to calculate a minimum distribution amount: Take your age and find the corresponding distribution period. Then, divide the value of your IRA by the distribution period to find the required minimum distribution.

UNIFORM LIFETIME TABLE		YOUR AGE	DISTRIBUTION PERIOD (IN YEARS)	YOUR AGE	DISTRIBUTION PERIOD (IN YEARS)	YOUR AGE	DISTRIBUTION PERIOD (IN YEARS)	YOUR AGE	DISTRIBUTION PERIOD (IN YEARS)
		70.....	27.4	82.....	17.1	94.....	9.1	106.....	4.2
		71.....	26.5	83.....	16.3	95.....	8.6	107.....	3.9
		72.....	25.6	84.....	15.5	96.....	8.1	108.....	3.7
		73.....	24.7	85.....	14.8	97.....	7.6	109.....	3.4
		74.....	23.8	86.....	14.1	98.....	7.1	110.....	3.1
		75.....	22.9	87.....	13.4	99.....	6.7	111.....	2.9
		76.....	22.0	88.....	12.7	100.....	6.3	112.....	2.6
		77.....	21.2	89.....	12.0	101.....	5.9	113.....	2.4
		78.....	20.3	90.....	11.4	102.....	5.5	114.....	2.1
		79.....	19.5	91.....	10.8	103.....	5.2	115.....	1.9
		80.....	18.7	92.....	10.2	104.....	4.9	or older	
		81.....	17.9	93.....	9.6	105.....	4.5		

Frequently Asked Questions

Most IRA owners use the Uniform Lifetime Table for calculating lifetime RMD after turning 70½. The only time you would not use this table would be if your spouse is your sole beneficiary for the entire year and is more than 10 years younger.

In case your spouse is the sole beneficiary for the entire year, and is more than 10 years younger than the IRA owner, you'd use the 14-page Joint Life Table from IRS Publication 590.

Q. What if I don't start taking RMD when I'm supposed to?

A. *The IRS gives you a big incentive to do it ... and do it right: A 50% excise tax on the amount not taken! So, for instance, if you forgot to withdraw \$20,000 as required, you'd have to cough up \$10,000 in penalties ... plus, the income tax owed. That's a big chunk of change!*

Q. How would the IRS know I didn't pull out enough money each year?

A. *Don't for a single moment think you'd get away with that. The IRS is implementing its goal of making sure that IRA owners and beneficiaries are withdrawing and paying tax on the required amounts. Therefore, IRA custodians must report to the IRS, accounts that are subject to RMD. The reporting will be done on Form 5498.*

Q. Last year, I lost a bundle in the market, and I just did the RMD calculation based on the preceding year's balance as required. The problem is that there's not enough money in the account now to cover my RMD. Will I get hit with the 50% penalty for not taking out the right amount?

A. *Normally you'd be looking at a 50% penalty for not taking the correct RMD. But the IRS has ruled that if an IRA has dropped to the point that the RMD exceeds the entire account balance, the owner can simply empty the account. And the 50% will not apply. So, you're in the clear.*

Q. I have a Roth IRA. Will I have to start RMD when I turn 70½?

A. *No. Roth IRA owners never have to worry about RMD. However, Roth IRA beneficiaries do, and they'll face a 50% penalty for not taking a required distribution, even though those distributions are generally tax-free.*

Frequently Asked Questions

Q. I have about \$1.3 million in my IRA, and most of it came from my company's plan when I retired. If I remember correctly, I was putting money into that plan after I had paid tax on it. Can I just remove the after-tax money when I'm forced to begin RMD? That way I wouldn't have to pay income tax.

A. *Very few people are going to have \$1 million IRA's that came from contributing \$3,000 a year, most will be from rollovers. It's possible that their previous plans allowed pre-tax and after-tax contributions.*

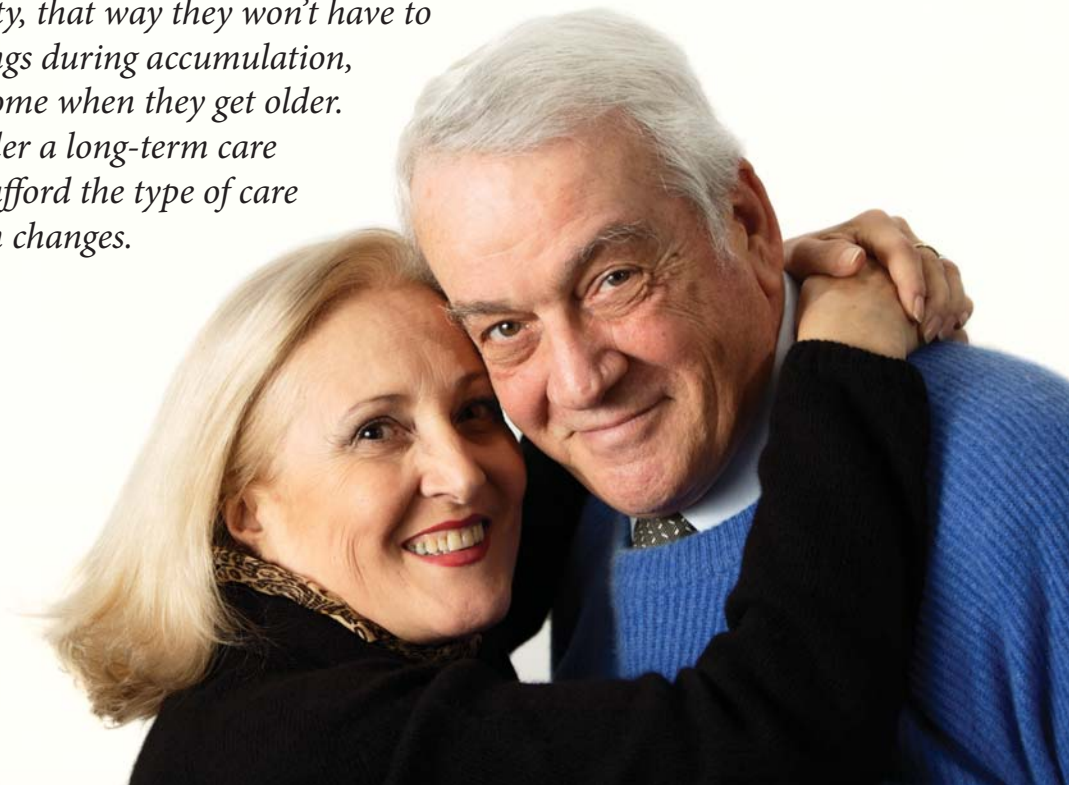
Although your idea is shrewd, the IRS is onto you. The after-tax funds have become part of your IRA and any withdrawals from the IRA are subject to the "Pro Rata Rule."

The Pro Rata Rule requires that each distribution from an IRA contain a proportionate amount of both the taxable and the nontaxable amounts in the account. The nontaxable amounts are called "basis." In an IRA, basis is the amount of nondeductible contributions made to the IRA.

Q. I'm about to begin my RMD. But I don't need the income right now. What do you think I should do with it?

A. *Many of our clients put the money each year into another tax-favored asset, such as a tax-deferred annuity, that way they won't have to pay income tax on the earnings during accumulation, and will have additional income when they get older.*

Or, you might want to consider a long-term care insurance policy so you can afford the type of care you'll want when your health changes.



Frequently Asked Questions

Q. I'm 62 and my wife is 60. She's the beneficiary on my IRA. Will she have to take RMD if something happens to me?

A. *Yes ... over her life expectancy when she turns 70 ½.*

Q. I've started taking my RMD. If I die before my wife, what'll she have to do?

A. *Your wife could rollover your IRA into her IRA. But she's not under any obligation to do so. And it can be done anytime, plus it gives her more flexibility.*

However, your year-of-death distribution must be taken before your wife could rollover your IRA to her IRA. The funds will then be considered hers and subject to the RMD based on her age.

Speaking of age ... you didn't mention her age, and we assume that she is younger. But, if she's older, she'd be better off using your remaining life RMD rather than her own. This will give her a longer time to withdraw the funds, which means smaller distributions and less income tax than if she used her shorter life expectancy.

Q. I realize that my IRA is part of my estate, and I estimated that my heirs might have to pay up to 50% in federal and state estate taxes on it when I die. So, does this mean my loved ones could lose 50% to estate taxes plus another 35% to federal income taxes?

A. *You're absolutely right! In most cases IRAs are exposed to income and estate taxes upon the owner's death. However, they can become stretch IRAs because of the distribution tables.*

So in your situation, 85% could disappear in flash! There is a way to protect against losing a big chunk of that.

An irrevocable life insurance trust could be set up to pay the estate tax. Then your beneficiaries could stretch the RMD, as well as the associated income tax, over their life expectancies.

Frequently Asked Questions

Q. My father died last year, and I was his IRA beneficiary. He was 66, so he hadn't started his RMD yet. I'm 41 and I don't need the money now, what can I do to pay as little income tax on the IRA as possible?

A. *The IRS won't let the money just sit there ... they want the tax on it. But you can stretch the payouts over your life expectancy (42.7 years) from the table below to determine the taxable distribution.*

For each succeeding year, you'll simply subtract one from the life expectancy. In this case, the required distribution for your second distribution year would be calculated using a 41.7-year life expectancy. For the third year, the life expectancy would be 40.7 years, then 39.7 years, 38.7 years, and so on until the original 42.7-year term has expired, unless you deplete the IRA before that time.

SINGLE LIFE EXPECTANCY TABLE (For Inherited IRAs)							
Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)
0	82.4	26	57.2	53	31.4	80	10.2
1	81.6	27	56.2	54	30.5	81	9.7
2	80.6	28	55.3	55	29.6	82	9.1
3	79.7	29	54.3	56	28.7	83	8.6
4	78.7	30	53.3	57	27.9	84	8.1
5	77.7	31	52.4	58	27.0	85	7.6
6	76.7	32	51.4	59	26.1	86	7.1
7	75.8	33	50.4	60	25.2	87	6.7
8	74.8	34	49.4	61	24.4	88	6.3
9	73.8	35	48.5	62	23.5	89	5.9
10	72.8	36	47.5	63	22.7	90	5.5
11	71.8	37	46.5	64	21.8	91	5.2
12	70.8	38	45.6	65	21.0	92	4.9
13	69.9	39	44.6	66	20.2	93	4.6
14	68.9	40	43.6	67	19.4	94	4.3
15	67.9	41	42.7	68	18.6	95	4.1
16	66.9	42	41.7	69	17.8	96	3.8
17	66.0	43	40.7	70	17.0	97	3.6
18	65.0	44	39.8	71	16.3	98	3.4
19	64.0	45	38.8	72	15.5	99	3.1
20	63.0	46	37.9	73	14.8	100	2.9
21	62.1	47	37.0	74	14.1	101	2.7
22	61.1	48	36.0	75	13.4	102	2.5
23	60.1	49	35.1	76	12.7	103	2.3
24	59.1	50	34.2	77	12.1	104	2.1
25	58.2	51	33.3	78	11.4	105	1.9
		52	32.3	79	10.8		

(For calculating post-death required distributions to beneficiaries)
(From IRS Publication 590)

Frequently Asked Questions

Q. I'm 61 and I have three children, ages 42, 25, and 21. I have named them equal beneficiaries for my IRA. Did I do the right thing?

A. *It's good that you named beneficiaries. But there's a potential problem here. When you die, your children's RMD will be based on the life expectancy of the oldest, which is 41.7 years. This means your 25-year-old would have to take the money out much faster than his or her life expectancy ... 58.2 years, and the 21-year-old will lose out the most.*

Therefore, it would be better that each beneficiary uses his or her own age for computing their RMD on the inherited IRA. This way if one beneficiary is 21-years old and another beneficiary is 42-years old, the 21-year old would not be forced to use the shorter life expectancy of a 42-year old.

Generally, the easiest way to take care of this is to create a separate account for each beneficiary while you are alive.

Q. I can't think of anyone to name as a beneficiary on my IRA. My three children are a disappointment, and my wife divorced me. I figure they can just fight it out among themselves after I'm gone. Will that mess up my RMD?

A. *Not yours, but certainly theirs, and it depends on whether you started your RMD before you died.*

When you don't name a beneficiary, the money goes to your estate, and if you die before your RMD begins, your estate's beneficiaries must withdraw the funds under the five-year rule. What's more, it doesn't matter how much they take out during the five-year-rule period, as long as the account is depleted by December 31 of the fifth year after your death. Any balance remaining will be burdened with the 50% penalty.

On the other hand, if you die after the RMD's start, the distribution period will be based on your life expectancy calculated in the year of death, reduced by one for each subsequent year.

So, what it comes down to is that they'd lose the ability to stretch the money out over their life expectancy. Thus, they'll pay taxes faster and probably not end with as much as they had hoped to.



Frequently Asked Questions

- Q. If I die first, my wife will need my IRA to support herself. I also have a 35-year old daughter who is financially independent. Is there anyway to leave my wife enough money and not have her worry about taking RMD and paying taxes?**
- A. Yes, there is. We have a strategy that will possibly let your wife avoid all estate and income taxes on your IRA. Plus, she won't have to hassle with RMD, and she'll be able to spend the money any way she pleases. ■**

More Information

We do hope this booklet has provided you with answers to your questions in regard to Required Minimum Distributions from your IRA. If you would like more information or perhaps some one-on-one guidance from a Financial Services Representative, please feel free to contact us at:

Paul E. Fair

Paul Fair Associates, LLC

625 North Park Road

Wyomissing, PA 19610

(610) 478-9500

Email: paul@paulfair.com

Web: www.paulfair.com

