An Overview of Required Minimum Distribution

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Abstract

Two and half millions of the seventy-four million living baby boomers turned age 70 in 2016. According to the required minimum distribution (RMD) rules, the 1946, 1947 and 1948 cohorts of baby boomers already started or are going to start to take RMDs. Everything related to retirement is complex. RMD is no exception. Failure to comply with the RMD rules can result in steep penalty. This paper discusses the basic rules of RMD that should satisfy the needs of most baby boomers.

Keywords: Required Minimum Distribution

Introduction

Seventy-six million American children were born between mid-1946 and mid-1964 (History.com) and they are referred to as baby boomers (Hogan, Perez, and Bell, 2008). Nearly 25 percent of the American population is boomers (Colby and Ortman, 2014). In 2016, two and half million living boomers turned 70 (Newcott, 2016) and in the following four years, about fourteen million (Colby and Ortman, 2014). According to the required minimum distribution (RMD) rules, the 1946 and 1947 cohorts of baby boomers already started or are going to start to take RMDs.

Everything related to retirement is complex. RMD is no exception. RMD is the minimum amount a person must withdraw from his/her retirement accounts every year starting at age 70½. RMD rules determines when, what accounts and how much to withdraw. Failure to take sufficient RMD in time can cause very heavy penalties. Though many papers have been written on RMD, most provide a partial discussion. This paper intends to give a complete picture of the basic RMD rules that should satisfy the needs of most baby boomers. Our discussions are based on the Internal Revenue Code section 401(a)(9). The rest of the paper contains five sections; Section 2 discusses the retirement accounts subject to RMD, Section 3 dates for withdrawing RMD, Section 4 penalty for failing to take sufficient RMD, Section 5 Calculation of RMDs and Section 6 rolling over 403(b) to IRA.

Accounts Subject to RMDs

All tax-deferred retirement accounts are subject to RMD, including traditional IRA, SIMPLE IRA, SEP IRA, 401(k) plan, 403(b) plan, 457(b) plan, profit-sharing plan, and other defined contribution plan. No RMD is required from Roth IRA while the owner is alive because it is not a tax-deferred account.

Dates for Withdrawing RMD

The required beginning date (RBD) is the latest date a person must withdraw his or her first RMD. RBD is April 1 of the calendar year following the year a person reaches age 70½. The date that a person turns age 70½ is his 70^{th} birthday plus six calendar months.

For each subsequent year after a person is 70½ years old, December 31 is the deadline for receiving RMD. If a participant receives his first RMD by RBD, the participant will have to make the second RMD withdrawal by December 31 of the same year. To avoid having to include both RMDs in the income in the same year, a person can withdraw his first RMD by December 31 of the year he turns 70½.

Example 1: Mary celebrated her 70th birthday on May 21, 2017. She'll turn age 70½ on November 21, 2017. She'll need to take her first (for 2017) RMD by April 1, 2018. She'll have to take her 2018 RMD by December 31, 2018. Taking two RMDs in 2018 could put her in a higher tax bracket. To avoid paying higher income tax, Mary may take her first RMD by December 31, 2017.

An exception to the RMD rules is if a person continues to work after age 70½, he does not have to take RMDs from his defined-contribution plans such as 401(k) and 403(b) until April 1 of the year following his year of retirement unless the plans require age-based minimum distributions or he owns at least five percent of the business that sponsors the defined-contribution plan. So if a person plans to keep working into his 70's, he'll need to take RMDs from all non-Roth IRAs. But he can let his 401(k) and/or 403(b) accumulate until April 1 following the calendar year when he retires.

Example 2: Mary is going to reach age 70½ on November 21, 2017 and she has no plan to retire till May 2020. She'll have to take RMDs from all of her non-Rose IRAs by April 1, 2018. She, however, can delay the RMDs from her 401(k) and 403(b) accounts till April 1, 2021, if she retires as planned.

Another exception is related to the 403(b) plan. If a participant has a 403(b) plan that has pre-1987 amounts and the amounts are separately accounted and recorded, he does not have to receive distribution from the pre-1987 amounts (excluding any earnings or gains) until December 31 of the year when he reaches age 75 or April 1 of the year immediately following his year of retirement, whichever occurs later.

Penalty for Failing to Take Sufficient RMD

A person has to pay a penalty of 50% excise tax on the difference between the amount withdrawn and the minimum amount required to be withdrawn.

Example 3: Joe turned age 70½ in 2015. Assume his RMDs for 2015 and 2016 were $5,000 and $4,000, respectively. He withdrew $5,000 on April 1, 2016. Due to mis-calculation, he withdrew only $3,000 on December 31, 2016. Joe had to file Form 5329 (IRS, 2016) to pay IRS a penalty of $500 ($4,000 - $3,000 = $1,000; $1,000 * 0.5 = $500) when he filed his 2016 tax return in 2017.

IRS might waive the 50% exercise tax on insufficient RMD if the account owner establishes that the failure to make the RMD is due to "reasonable error", and "reasonable steps are being taken to remedy the shortfall". Unfortunately, there is no published list of reasonable errors regarding insufficient RMD (Choate, 2015).

Please note that an over-distributed amount in one year does not carry forward to the following year. Also, one can't roll over RMD into another tax-deferred account.

Example 4: Mary's RMDs for 2015 and 2016 were $5,000 and $4,000, respectively. Due to a special need, she decided to receive a distribution of $6,500 in 2015. She, however, withdrew only $3,000 in 2016, $1,000 below the RMD. Though Mary over-withdrew $1,500 in 2015, the excess amount does not count toward 2016. She had to pay a penalty of $500.

Calculation of RMDs

For each of the tax-deferred retirement account, the RMD is calculated using the following formula.

RMD = Account Balance at the End of Year J-1 / Distribution Period where Year J is the year a participant turns age 70½

Distribution period is determined by using one of the three tables in Publication 590-B (IRS, 2016). The three tables are used for all tax-deferred retirement accounts. Table I is "for use by beneficiaries". Table II is "for use by owners whose spouses are more than 10 years younger and are the sole beneficiaries of their IRAs". Table III is for all other cases and is the most commonly used one. Table II (partial) and Table III are reproduced below. Your accounts' administrators/sponsors may calculate the RMDs for you.

Example 5: Joe's wife is thirteen years younger than he and is the sole beneficiary of their IRAs. Joe reached age 71 on November 25, 2016. Joe's IRA account balance was $28,600 as of December 31, 2015. Because Joe's wife is more than 10 years younger than he and is the sole beneficiary of his IRA, Table II in Publication 590-B is used. Based on their ages on December 31, 2016, the joint life expectancy for Joe (age 71) and his wife (age 58) is 28.6 years. The RMD for 2016 to be taken by April 1, 2017 is $1,000 ($28,600 / 28.6 = $1,000).

Example 6: Mary is single. She was age 75 at the end of 2016 and had $229,000 in her 401(k) account as of December 31, 2015. Because she is not married and is the owner of her 401(k) account, she uses Table III. Her distribution period is 22.9 years. She had to withdraw $10,000 ($229,000/22.9 = $10,000) from her 401(k) account to meet her 2016 RMD by December 31, 2016. If she is still working, no minimum distribution from her 401(k) is required.

A participant may have multiple non-Roth IRAs. He has to calculate the RMD for each IRA. However, he does not have to withdraw from every account. He can take the distributions from one or more accounts multiple times so long as the total amount received is not lower than the sum of RMDs for all of his IRAs.

Rolling over 403(B) to IRA

When a participant is age 59½ or older, he may roll over money in his 403(b) account to a traditional IRA account. A big benefit of rolling over a 403(b) to an IRA is that there are more investing options. The fees with an IRA are also typically lower than what a 403(b) plan charges. However, as mentioned above, if a participant continues to work after age 70½, RMD applies to IRA but not 403(b). Deciding whether to roll over a 403(b) account to a regular IRA account, a person should carefully consider his personal situation and preferences.

A Comprehensive Example

Example 7: Joe celebrated his 70th birthday on November 8, 2016. His lovely wife is three years younger than he. Using Table III, Joe found his distribution period is 26.5, the period corresponding to age 71. If Joe is retired, he'll have to receive distributions from all three accounts for 2017 by April 1, 2018. The balances of his retirement accounts as of December 31, 2016 and possible RMDs by April 1, 2018 are shown below.

Accounts	Balance as of December 31, 2016	RMDs by April 2018
410(k)	$300,000	$11,320.75
403(b)	$200,000	$7,547.17
Traditional IRA	$100,000	$3,773.58

Joe'll also have to make another round of withdrawals from his retirement accounts for 2018 by December 31, 2018. His distribution period for 2018 is 25.6.

If Joe is still working, he'll only has to make a withdrawal from his traditional IRA account.

Summary

There are seventy four millions living baby boomers. Two and half millions of them turned age 70 in 2016. Boomers have to understand RMD rules. Failure to comply with the RMD rules can result in steep penalty. This paper discusses the basic rules of RMD that should satisfy the needs of most baby boomers. The topics discussed include (1) the retirement accounts subject to RMD, (2) dates for withdrawing RMD, (3) penalty for failing to take sufficient RMD, (4) calculation of RMDs and (5) rolling over 403(b) to IRA.

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Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	50	51	52	53	54	55	56	57	58	59
57	37.6	37.0	36.4	35.8	35.2	34.7	34.2	33.7	33.2	32.8
58	37.3	36.7	36.0	35.4	34.8	34.3	33.7	33.2	32.8	32.3
59	37.1	36.4	35.7	35.1	34.5	33.9	33.3	32.8	32.3	31.8
60	36.8	36.1	35.4	34.8	34.1	33.5	32.9	32.4	31.9	31.3
61	36.6	35.8	35.1	34.5	33.8	33.2	32.6	32.0	31.4	30.9
62	36.3	35.6	34.9	34.2	33.5	32.9	32.2	31.6	31.1	30.5
63	36.1	35.4	34.6	33.9	33.2	32.6	31.9	31.3	30.7	30.1
64	35.9	35.2	34.4	33.7	33.0	32.3	31.6	31.0	30.4	29.8
65	35.8	35.0	34.2	33.5	32.7	32.0	31.4	30.7	30.0	29.4
66	35.6	34.8	34.0	33.3	32.5	31.8	31.1	30.4	29.8	29.1
67	35.5	34.7	33.9	33.1	32.3	31.6	30.9	30.2	29.5	28.8
68	35.3	34.5	33.7	32.9	32.1	31.4	30.7	29.9	29.2	28.6
69	35.2	34.4	33.6	32.8	32.0	31.2	30.5	29.7	29.0	28.3
70	35.1	34.3	33.4	32.6	31.8	31.1	30.3	29.5	28.8	28.1
71	35.0	34.2	33.3	32.5	31.7	30.9	30.1	29.4	28.6	27.9
72	34.9	34.1	33.2	32.4	31.6	30.8	30.0	29.2	28.4	27.7
73	34.8	34.0	33.1	32.3	31.5	30.6	29.8	29.1	28.3	27.5
74	34.8	33.9	33.0	32.2	31.4	30.5	29.7	28.9	28.1	27.4
75	34.7	33.8	33.0	32.1	31.3	30.4	29.6	28.8	28.0	27.2
76	34.6	33.8	32.9	32.0	31.2	30.3	29.5	28.7	27.9	27.1
77	34.6	33.7	32.8	32.0	31.1	30.3	29.4	28.6	27.8	27.0
78	34.5	33.6	32.8	31.9	31.0	30.2	29.3	28.5	27.7	26.9
79	34.5	33.6	32.7	31.8	31.0	30.1	29.3	28.4	27.6	26.8
80	34.5	33.6	32.7	31.8	30.9	30.1	29.2	28.4	27.5	26.7
81	34.4	33.5	32.6	31.8	30.9	30.0	29.2	28.3	27.5	26.6
82	34.4	33.5	32.6	31.7	30.8	30.0	29.1	28.3	27.4	26.6
83	34.4	33.5	32.6	31.7	30.8	29.9	29.1	28.2	27.4	26.5
84	34.3	33.4	32.5	31.7	30.8	29.9	29.0	28.2	27.3	26.5
85	34.3	33.4	32.5	31.6	30.7	29.9	29.0	28.1	27.3	26.4
86	34.3	33.4	32.5	31.6	30.7	29.8	29.0	28.1	27.2	26.4
87	34.3	33.4	32.5	31.6	30.7	29.8	28.9	28.1	27.2	26.4
88	34.3	33.4	32.5	31.6	30.7	29.8	28.9	28.0	27.2	26.3
89	34.3	33.3	32.4	31.5	30.7	29.8	28.9	28.0	27.2	26.3
90	34.2	33.3	32.4	31.5	30.6	29.8	28.9	28.0	27.1	26.3
91	34.2	33.3	32.4	31.5	30.6	29.7	28.9	28.0	27.1	26.3
92	34.2	33.3	32.4	31.5	30.6	29.7	28.8	28.0	27.1	26.2
93	34.2	33.3	32.4	31.5	30.6	29.7	28.8	28.0	27.1	26.2
94	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.1	26.2
95	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.1	26.2
96	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.2

Source: IRS Publication 590-B

Table III
(Uniform Lifetime)

(For Use by:
- **Unmarried Owners,**
- **Married Owners Whose Spouses Are Not More Than 10 Years Younger, and**
- **Married Owners Whose Spouses Are Not the Sole Beneficiaries of Their IRAs)**

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

Source: IRS Publication 590-B