Distributions from Traditional IRAs After Age 73

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Introduction

A withdrawal from an IRA is generally referred to as a distribution. Ideally, you would have complete control over the timing of distributions from your traditional IRAs. Then you could leave your funds in your traditional IRAs for as long as you wished, and withdraw the funds only if you really needed them. This would enable you to maximize the funds' tax-deferred growth in the IRA, and minimize your annual income tax liability. Unfortunately, it doesn't work this way. Eventually, you must take what are known as required minimum distributions from your traditional IRAs.

Caution: This discussion pertains primarily to distributions from traditional IRAs. Special rules apply to Roth IRAs.

Caution: This article applies to distributions to IRA owners. Special rules apply to distributions to IRA beneficiaries.

What are required minimum distributions (RMDs)?

Required minimum distributions (RMDs), sometimes referred to as minimum required distributions (MRDs), are withdrawals that the federal government requires you to take annually from your traditional IRAs after you reach age 73 (for those who reach age 72 after December 31, 2022; prior to December 31, 2022, the age was either 72 or 70½, depending on your year of birth). You can always withdraw more than the required minimum from your IRA in any year if you wish, but if you withdraw less than required, you will be subject to a federal penalty tax. These RMDs are calculated to dispose of your entire interest in the IRA over a specified period of time. The purpose of this federal rule is to ensure that people use their IRAs to fund their retirement, and not simply as a vehicle of wealth accumulation and transfer.

Tip: In addition to traditional IRAs, most employer-sponsored retirement plans are subject to the RMD rule. Roth IRAs, however, are not subject to this rule. You are not required to take any distributions from a Roth IRA during your lifetime.

When must RMDs be taken?

Your first RMD from your traditional IRA represents your distribution for the year in which you reach age 73. However, you have some flexibility in terms of when you actually have to take this first-year distribution. You can take it during the year you reach age 73, or you can delay it until April 1 of the following year. Since your first distribution generally must be taken no later than April 1 following the year you reach age 73, this date is known as your required beginning date (RBD). Required distributions for subsequent years must be taken no later than December 31 of each calendar year until you die or your balance is reduced to zero. This means that if you opt to delay your first distribution until the following year, you will be required to take two distributions during that year — your first year required distribution and your second year required distribution.

Example(s): You own a traditional IRA. Your 73rd birthday is December 2, 2024. You can take your first RMD during 2024, or you can delay it until April 1, 2025. If you choose to delay your first distribution, you will have to take two required distributions in 2025 — one for 2024 and one for 2025. That is because your required distribution for year two cannot be delayed until the following year.

Caution: Your beneficiary generally must withdraw any distribution required for the year of your death if you haven't yet taken it.

Should you delay your first RMD?

Your first decision is when to take your first RMD. Remember, you have the option of delaying your first distribution until April 1 following the calendar year in which you reach age 73. You might delay taking your first distribution if you expect to be in a lower income tax bracket in the following year, perhaps because you're no longer working or will have less income from other sources. However, if you wait until the following year to take your first distribution, your second distribution must be made on or by December 31 of that same year.

Receiving your first and second RMDs in the same year may not be in your best interest. Since this "double" distribution will increase your taxable income for the year, it will probably cause you to pay more in federal and state income taxes. It could even push you into a higher federal income tax bracket for the year. In addition, the increased income may cause you to lose the benefit of certain tax exemptions and deductions that might otherwise be available to you. So, the decision of whether or not to delay your first required distribution can be crucial and should be based on your personal tax situation.

How are RMDs calculated?

RMDs are calculated by dividing your traditional IRA account balance by the applicable distribution period. Your account balance is calculated as of December 31 of the year preceding the calendar year for which the distribution is required to be made.

Example(s): You have a traditional IRA. Your 73rd birthday is November 1, 2024. Your first RMD must be taken no later than April 1 of 2025. In calculating this RMD, you must use the total value of your IRA as of December 31, 2023.

Caution: *When calculating the RMD amount for your second distribution year, you base the calculation on the total interest in the IRA or plan as of December 31 of the first distribution year (the year you reached age 73), regardless of whether or not you waited until April 1 of the following year to take your first required distribution.*

What if you fail to take RMDs as required?

If you fail to take at least your RMD amount for any year (or if you take it too late), you will be subject to a federal penalty tax. The penalty tax is a 25% excise tax on the amount by which the required amount exceeds the amount actually distributed to you during the taxable year.

Example(s): You own a single traditional IRA and compute your RMD for year one to be $7,000. You take only $2,000 as a year-one distribution from the IRA by the date required. Since you are required to take at least $7,000 as a distribution but have taken only $2,000, your RMD (the required amount) exceeds the amount of your actual distribution by $5,000 ($7,000 minus $2,000). You are therefore subject to an excise tax of $1,250 (25% of $5,000), reportable and payable on your year-one tax return.

Technical Note: You report and pay the 25% tax on your federal income tax return for the calendar year in which the distribution shortfall occurs. You should complete and attach IRS Form 5329, "Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts." The tax can be waived if you can demonstrate that your failure to take adequate distributions was due to "reasonable error," and that steps have been taken to correct the insufficient distribution. You must file Form 5329 with your individual income tax return and attach a letter of explanation. The IRS will review the information you provide, and decide whether to grant your request for a waiver.

Technical Note: The SECURE 2.0 Act of 2022 established a two-year period to correct a failure to take a timely RMD, with a resulting reduction in the tax penalty to 10%. As of mid-year 2023, it is unclear how the IRS will determine whether a waiver or a reduction in the penalty will apply to a given situation.

Tax considerations

Income tax
Like all distributions from traditional IRAs, distributions taken after age 73 are generally subject to federal (and possibly state) income tax for the year in which you receive the distribution. However, a portion of the funds distributed to you may not be subject to tax if you have ever made nondeductible (after-tax) contributions or if you've ever rolled over after-tax dollars from an employer-sponsored retirement plan to your traditional IRA. Since nondeductible contribution amounts were taxed once already, they will be tax free when you withdraw them from the IRA. You should consult a tax professional if your traditional IRA contains any nondeductible contributions.

Caution: *Taxable income from an IRA is taxed at ordinary income tax rates even if the funds represent long-term capital gains or qualified dividends from stock held within the IRA.*

Caution: *Special rules apply to Roth IRAs. Qualified distributions from Roth IRAs are tax-free. Even Roth IRA distributions that don't qualify for tax-free treatment are tax-free to the extent they represent your own contributions to the Roth IRA. Only after you've recovered all your contributions are distributions considered to consist of taxable earnings. Further, special rules apply to distributions taken from Roth IRAs that have funds rolled over or converted from traditional IRAs.*

When you take a distribution from your traditional IRA, there is no requirement that your IRA trustee or custodian withhold federal income tax on the distribution. However, the trustee or custodian generally will withhold tax at a rate of 10% unless you provide the trustee or custodian with written instructions that you do not want any tax withheld on the distribution. Even if tax is withheld at 10%, that may not be sufficient to cover your full tax liability on the distribution.

Tip: If you receive an annuity or similar periodic payment, tax withholding is generally based on your marital status and the number of withholding allowances you claim on your withholding certificate (Form W-4P). No withholding or waiver is needed when the distribution is a trustee-to-

trustee transfer (aka direct rollover) from one IRA to another (see below).

Estate tax
You first need to determine whether or not federal estate tax will apply to you. If you do not expect the value of your taxable estate to exceed the federal applicable exclusion amount, then federal estate tax may not be a concern for you. Otherwise, you may want to consider appropriate strategies to minimize your future estate tax liability.

For example, you might reduce the value of your taxable estate by gifting all or part of your RMD to your spouse or others. Making gifts to your spouse may work well if your taxable estate is larger than your spouse's, and one or both of you will leave an estate larger than the applicable exclusion amount. This strategy can provide your spouse with additional assets to better utilize their applicable exclusion amount, thereby minimizing the combined estate tax liability of you and your spouse. Be sure to consult an estate planning attorney, however, about this and other strategies.

Caution: *In addition to federal estate tax, your state may impose its own estate or death tax at thresholds that could be far lower than the federal levels. Consult an estate planning attorney for details.*

IRA rollovers and transfers

In general, there are two ways to transfer assets between IRAs — indirect, 60-day rollovers and trustee-to-trustee transfers (also known as "direct rollovers"). With an indirect rollover, you receive funds from the distributing IRA and then complete the rollover by depositing funds into the receiving IRA within 60 days. A trustee-to-trustee transfer is a transaction directly between IRA trustees and custodians. If properly completed, indirect rollovers and trustee-to-trustee transfers are not subject to income tax or the 10% premature distribution tax.

Although there are no age limits for indirect rollovers or trustee-to-trustee transfers, you must remember to take your RMD each year after you reach age 73 (you cannot roll over or transfer an RMD itself).

Tip: You can roll over (or transfer) funds from a traditional IRA to another traditional IRA or from a Roth IRA to another Roth IRA. Special rules apply to converting or rolling over funds from a traditional IRA to a Roth IRA. You may also be able to roll over or transfer taxable funds from an IRA to an employer-sponsored retirement plan.

60-day rollover: You receive the funds and reinvest them
With an indirect rollover, you actually receive a distribution from your IRA and then, to complete the rollover, you deposit all or part of the distribution into the receiving IRA within 60 days of the date the funds are released from the distributing account.

Example(s): On January 2, you withdraw your IRA funds from a maturing bank CD and choose to have no income tax withheld. The bank cuts a check payable to you for the full balance of the account. You plan to move the funds into an IRA account at a competing bank. Fifteen days later, you go to the new bank and deposit the full amount of your IRA distribution into your new rollover IRA. Your rollover is complete.

If you don't complete the rollover transaction, or you miss the 60-day deadline, your distribution is taxable to you. However, there are several ways to seek waiver of the 60-day deadline, including an automatic waiver in some cases, self-certification if you missed the deadline due to one of 11 specified reasons, or by seeking a private letter ruling from the IRS. (If you roll over part, but not all, of your distribution within the 60-day period, then only the portion not rolled over is treated as a taxable distribution.)

Example(s): Assume the same scenario as the first example, except that when you receive your check from the first bank, you cash the check and lend the money to your brother, who promises to repay you in 30 days. As it turns out, he doesn't repay the loan until March 5 (the 62nd day after your distribution). You deposit the full sum into the IRA account at the new bank. However, because you didn't complete your rollover within 60 days, the January 2 distribution will be taxable (excluding any nondeductible contributions, as described above).

Caution: *You can make only one tax-free, 60-day, rollover from one IRA to another IRA in any one-year period no matter how many IRAs (traditional, Roth, SEP and SIMPLE) you own. This does not apply to direct (trustee-to-trustee) transfers or Roth IRA conversions.*

If you roll over part, but not all, of your distribution within the 60-day period, then only the portion not rolled over is treated as a taxable distribution.

When you take a distribution from your traditional IRA, your IRA trustee or custodian will generally withhold 10% for federal income tax (and possibly additional amounts for state tax and penalties) unless you instruct them not to. If tax is withheld and you then wish to roll over the distribution, you have to make up the amount withheld out of your own pocket. Otherwise, the rollover is not considered complete, and the shortfall is treated as a taxable distribution. The best way to avoid this outcome is to instruct your IRA trustee or custodian not to withhold any tax. Unlike distributions from qualified plans, IRA distributions are not subject to a mandatory withholding requirement.

Example(s): You take a $1,000 distribution (all of which would be taxable) from your traditional IRA that you want to roll over into a new IRA. One hundred dollars is withheld for federal income tax, so you actually receive only $900. If you roll over only the $900, you are treated as having received a $100 taxable distribution. To roll over the entire $1,000, you will have to deposit in the new IRA the $900 that you actually received, plus an additional $100. (The $100 withheld will be claimed as part of your credit for federal income tax withheld on your federal income tax return.)

Trustee-to-trustee transfer
A trustee-to-trustee transfer (direct rollover) occurs directly between the trustee or custodian of your old IRA, and the trustee or custodian of your new IRA. You never actually receive the funds or have control of them, so a trustee-to-trustee transfer is not treated as a distribution (and therefore, the issue of tax withholding does not apply). Trustee-to-trustee transfers are not subject to the 60-day deadline, or the "one-rollover-per-12-month " limitation.

Example(s): You have an IRA invested in a bank CD with a maturity date of January 2. In December, you provide your bank with instructions to close your CD on the maturity date and transfer the funds to another bank that is paying a higher CD rate. On January 2, your bank issues a check payable to the new bank (as trustee for your IRA) and sends it to the new bank. The new bank deposits the IRA check into your new CD account, and your trustee-to-trustee transfer is complete.

Trustee-to-trustee transfers avoid the danger of missing the 60-day deadline, and are generally the most efficient way to move IRA funds. Taking a distribution yourself and rolling it over only makes sense if you need to use the funds temporarily and are certain you can roll over the full amount within 60 days.

Converting or rolling over traditional IRAs to Roth IRAs

Have you done a comparison and decided that a Roth IRA is a better savings tool for you than a traditional IRA? If so, you may be able to convert or roll over an existing traditional IRA to a Roth IRA. However, be aware that you will have to pay income tax on all or part of the traditional IRA funds that you move to a Roth IRA. It is important to weigh these tax consequences against the perceived advantages of the Roth IRA. This is a complicated decision, so be sure to seek professional assistance.