MONEY

Mark Your Calendar: Most Required Minimum Distributions Due Dec. 31

As with all things tax related, you don't want to miss the deadline

ISTOCK / GETTY IMAGES

By John Waggoner, AARP

October 26, 2022

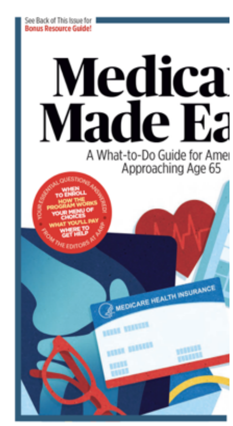
Required minimum distributions (RMDs) from employer-based retirement plans and traditional individual retirement accounts (IRAs) will be due Dec. 31 for most people 72 and older. Those distributions are taxable, and that can take the sparkle out of many taxpayers' holidays.

Although you can't avoid RMDs, you can

take some steps to minimize them. And in most cases, it’s best to take those steps before New Year’s Eve.

How RMDs work

There’s a reason accountants call traditional IRAs and other retirement plans “tax-deferred plans,” not “tax-free plans.” You don’t pay taxes on your account contributions or earnings — until you take withdrawals. And there’s a deadline for how long you can wait before taking the distributions that federal tax law requires. When you turn



10 THINGS EVERYON

72, you must start taking RMDs every year. These rules apply not just to IRAs but also to 401(k), 403(b) and other retirement plans. Roth IRAs are not subject to RMDs, but Roth 401(k)s are.

RMDs are based the IRS life expectancy tables. For example, at 72, the average person is expected to live another 27.4 years. To figure the RMD for that year, a person would divide her IRA balance by 27.4. If the balance were $100,000, the person would have to withdraw $3,650, and pay taxes on the withdrawal.

With one exception, you must take your RMD by Dec. 31. The exception: When you turn 72, you have until April 1 of the following year to take your RMD and pay taxes on it. Years ago, Congress determined that it would be benevolent to give people a three-month grace period on their first RMD, says IRA expert Ed Slott. "But that's not really a great deal, either," Slott says. Why?

Because you'll also have to make an RMD by Dec. 31 of that same year — in effect, making two RMDs in one year and possibly pushing you into a higher tax bracket. You're probably better off paying your first RMD in the year in which you turn 72, Slott says.

Your RMDs are based on the value of all your tax-deferred accounts as of Dec. 31 of the previous year. If you have several tax-deferred accounts, you have to figure out the RMD for each one. You may, however, take the entire RMD out of just one account. If you have already taken distributions during the year that are equal to or more than your required RMD, you don't have to do anything else to satisfy the RMD requirement.

The penalty for not taking an RMD is severe: 50 percent of the amount you should have taken out. If you neglect to take a $3,000 RMD, you'll owe a $1,500 penalty. Although the IRS will sometimes forgive the penalty, it's best not to incur it in the first place.

Making the best of things

Financial planners note that RMDs are

generally not a happy topic with their clients. “People don’t like RMDs because they don’t like the taxes they have to pay on the withdrawals,” says Jeremy Finger, a financial planner at Riverbend Wealth Management in Myrtle Beach, South Carolina. “This is especially true if they don’t need the money.”

Nevertheless, taking RMDs isn’t the worst thing in the world. “If you have large RMDs, that means your account is working well — you don’t want your RMDs getting smaller, which means the account is not growing,” says Catherine Valega, a financial planner at Green Bee Advisory in Winchester, Massachusetts.

And, says Slott, most people aren't required to take an RMD, because about 80 percent withdraw more than the required amount anyway. The remainder hate taking RMDs because they don't need the money, he says.

If you think you have to take an RMD, AARP has a handy RMD estimator that you can use to figure your RMD for any age. You don't have to take your RMD in one lump sum; you can withdraw it over the course of the year.

One strategy to reduce your RMDs: Convert your traditional IRAs to Roth IRAs before you reach age 72. You'll have to pay taxes on the amount you convert, but you can keep the remainder growing tax-free — and RMD-free. A word of caution: If you convert an IRA to a Roth when you're required to take distributions, you still have to pay your RMD. You can't convert an RMD into a Roth.

Another strategy: Give your RMD to charity. Current tax law allows you to contribute up to $100,000 to charity from an IRA and exclude that donation from your income. "That is a fantastic provision for people who are charitably inclined, and even more so now because most people no longer itemize their deductions due to the higher standard deductions," Slott says.

Finally, there is some small comfort from the IRS, which has updated its actuarial tables for RMDs to reflect longer life spans. The longer life span in the tables reduces the amount of RMD that people will have to pay. "You can take out a little less now, based on the new tables, and pay a little less," Slott says.

John Waggoner covers all things financial for AARP, from budgeting and taxes to retirement planning and Social Security. Previously he was a reporter for Kiplinger's Personal Finance and USA Today.
