The Return Of RMDs

COVID-19-Related Suspension Of RMDs Is A Thing Of The Past

The temporary reprieve is over. Due to the COVID-19 pandemic, Congress suspended the rules for required minimum distributions (RMDs) in 2020, including inherited accounts. But the rules have been restored for the 2021 tax year. Essentially, participants in qualified plans and IRAs who've reached their required beginning date must take 2021 distributions or potentially pay a hefty penalty.

The deadline for RMDs is December 31, 2021 (later for those that reach the required age in 2021), but you should get your ducks in a row before then.

Starting Point

Be aware that the RMD rules apply to employer-based retirement plans — including pension and profit-sharing plans, 401(k) plans, 403(b) plans for nonprofits and 457(b) plans for government entities — as well as traditional IRAs. Roth IRAs — other than those that are inherited — are exempt from distributions.

Previously, the required beginning date for participants in these plans was April 1 of the year following the year in which you turned age 70½. However, the Setting Every Community Up for Retirement Enhancement (SECURE) Act pushed the required beginning date to age 72, as of 2020. Therefore, if you turn 72 this year, you must begin taking distributions from qualified plans and IRAs by April 1, 2022.

But remember that RMD rules continue to apply for each succeeding tax year with a deadline of December 31. Thus, for the 2022 tax year, the usual deadline for RMDs is December 31, 2022. So, if you're turning age 72 in 2021, you may end up taking two year's worth of RMDs in the same tax year.

To avoid this scenario, you might arrange to receive your initial RMD in 2021. Calculate your tax liability both ways before the clock strikes twelve on December 31.

Ins And Outs Of Withdrawals

How much is your annual RMD? It depends on the value of the account on December 31 of the prior year. In other words, your RMD for 2021 is based on the account balance as of December 31, 2020. The IRS has created tables for calculating your RMD, but you may also use an online calculator or have your financial advisor perform the calculations for you.

Depending on your situation, you may be able to "pick your poison" when it comes to taking distributions if you own multiple accounts. (See "When one RMD is enough" below.)

Of course, there's nothing stopping you from taking more than the required amount based on the IRS tables. Just be aware that this reduces your nest egg for the future and should be accounted into your estate plan.

If you fail to meet your RMD obligations, the IRS can impose a steep penalty equal to 50% of the amount that should've been withdrawn (reduced by any actual withdrawals). For example, if the required withdrawal is $20,000 and you took out only $5,000, the penalty is $7,500 (50% of $15,000) — that's in addition to the regular income tax you owe on the distributions.

Other Factors To Consider

You don't have to take RMDs from a qualified plan of an employer if you still work full-time for the employer and you don't own more than 5% of the company. But this "still working exception" applies only to qualified plans such as 401(k) plans — not IRAs.

Alternatively, you might transfer up to $100,000 directly from an IRA to a charity without paying any federal income tax on the distribution ($200,000 for a married couple if both spouses separately qualify). But these "qualified charitable distributions" (QCDs) aren't tax deductible, even if you itemize. Extra tax incentive: QCDs count as RMDs that can satisfy your obligations for the year.

For inherited accounts where the original owner died after 2019, a nonspouse beneficiary is generally required to complete withdrawals by December 31 of the tenth year after the original owner's death. RMD rules for accounts inherited prior to 2020 are calculated differently.

Note, though, that if the account owner dies after the required beginning date, and hasn't taken an RMD for the year of death, then the beneficiaries of the account must take the account owner's RMD as a distribution for that year.

Spousal beneficiaries have greater flexibility than nonspousal beneficiaries, including being able to treat the account as his or her own, regardless of when the original owner died.

Year End Is Approaching

The temporary, one-year reprieve for taking RMDs has passed. Make arrangements now for your RMD in advance of the December 31 deadline. Also, confirm the required amount with your advisor to ensure you're not overpaying yourself.

SIDEBAR: When One RMD Is Enough

Generally, IRA participants take a required minimum distribution (RMD) annually from each account to meet their obligations and avoid penalties. But it doesn't have to be that way.

If it suits your purposes, you can arrange to receive the total amount required from just one IRA (or perhaps two or three). It doesn't matter where you take the money from as long as at least the minimum amount of total dollars is paid out. This could be preferable based on investment performance in various accounts.

This option generally isn't available for qualified plans like 401(k) plans. RMDs must be taken separately from each of these plan accounts.

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