TOPIC: DISTRIBUTIONS FROM IRA ACCOUNTS

The laws applicable to withdrawals (distributions) from individual retirement accounts (IRA's) and qualified retirement plans are numerous and complex. It is important to clearly understand your choices and obligations when it comes to receiving the proceeds from your retirement savings account. This article addresses the general issues facing IRA account holders when receiving distributions.

Taxation

The taxation of IRA distributions can be separated into two components: ordinary income tax treatment and potential additional tax penalties.

Ordinary Income Tax Treatment

Ordinary income tax treatment of your IRA distribution depends upon whether your contributions were "deductible" or "non-deductible" (or, "pre-tax" or "after-tax") when they were made. If your contributions qualified as deductible in the year that you made them, you were able to reduce your taxable income by the amount of the contribution in that year. When you withdraw these deductible contributions, you will be subject to the taxes on these contributions. If your contributions did not qualify as deductible, they were categorized as non-deductible and you were not able to defer the taxes on the amount you contributed.

The tax treatment of IRA distributions from the two types of contributions is summarized below:

- If the IRA contributions were deductible when they were made, the full amount of the distribution (contributions plus any earnings generated) is taxed as ordinary income.

- If the IRA contributions were non-deductible, only the earnings generated from the contributions are taxed as ordinary income while the contributions themselves are tax-free.

IRS Form 8606 is used to calculate the nontaxable and taxable portions of your withdrawal.

Additional Penalties/Requirements

If you withdraw funds from your IRA prior to age 59 ½, you may be subject to a 10% early withdrawal penalty with certain exceptions. These exceptions include:

- Certain unreimbursed medical expenses and medical insurance premiums
- Qualified higher (college, university or vocational school) educational expenses
- First-time home buyers (lifetime limitation of $10,000)
- Death or total disability of the retirement account owner
- Substantially equal periodic payments made over the owner's life expectancy or joint life expectancy with the owner's designated beneficiary, and at least until the longer of 5 years or age 59 ½ (See IRS Revenue Ruling 2002-62 for more details)

You can also avoid the 10% early withdrawal penalty and any other taxes due on your withdrawal if you rollover the funds to the same or another IRA within 60 days of receiving the funds. You are only allowed one rollover per person within a 12-month period.

Between the ages of 59½ and 70½, you may generally withdraw assets from your IRA without penalty. Distributions can take the form of lump sums, one time requests or regularly scheduled payments.

When you reach age 70½, the IRS requires that you begin taking at least a minimum distribution each year. This minimum distribution is called the Required Minimum Distribution (RMD). A 50% excise tax may be imposed if the amount actually distributed is less than the RMD.

RMD Calculation

The following two factors are used in determining your IRA's RMD:

- The fair market value of **all** your IRAs as of December 31st of the preceding year.

- A life expectancy factor found on the Minimum Distribution Incidental Benefit (MDIB) table, found in IRS Publication 590. Normally, you will use the uniform lifetime table to determine the appropriate life expectancy factor. However, if your spouse is named as the sole primary beneficiary of your IRA account and is more than 10 years younger than you, you should use the joint and last survivor life expectancy table.

The formula applied each year is:

$$\text{RMD} = \frac{\text{Fair Market Value of } \textbf{all} \text{ IRA's as of December 31}}{\text{Uniform (or joint) life expectancy factor from IRS tables}}$$

Unlike many qualified retirement plans such as 401(k)s, owners of multiple IRAs can choose to fulfill their RMD from any one or combination of their IRAs. The distributions do not have to be taken from each IRA pro-rata.

Distributions Upon Death

When the original owner of an IRA dies, the beneficiary must be determined by September 30th of the following year. The newly named beneficiary may then use his or her own single life expectancy factor to continue the Required Minimum Distributions (see separate regulations for determining RMDs from Inherited IRAs). If the account owner dies prior to having begun the RMD, and has not named a beneficiary for his IRA account, the assets will be forced to be paid out to the decedent's estate by December 31st of the fifth year following the year of death.

Other Distribution Considerations

All assets held in IRA accounts upon the owner's death are included in the owner's taxable estate. As a result, the IRA assets may be subject to estate taxes upon the owner's death, as well as income taxes when the beneficiary distributes assets from the IRA.

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