Tax Issues to Consider as you Near Retirement Age

Taxpayers approaching retirement should review the requirements for taking distributions from their qualified retirement plans and put an estate plan in place if they have not already done so.

Taxpayers are required to distribute to themselves minimum distributions (RMDs) from retirement accounts they hold such as 401(k)<javascript:void(0)> plans, traditional (but not Roth) IRAs, and 403(b)<javascript:void(0)> plans once you reach age 70-1/2.

Required Minimum Distributions (RMDs)

In general, distributions from a qualified plan must begin no later than April 1 of the year following the year in which the account owner attains age 70-1/2.

Distributions are calculated based on the account balance for the year prior to the year in which the distribution is being taken.

Another factor used to determine the amount that must be taken as a distribution is the taxpayer's life expectancy.

The IRS provides tables in IRS Publication 590. (Yes, the IRS has conveniently figured out when you should die - well for tax purposes anyways).

The penalty for missing an RMD is substantial.

A 50-percent penalty is applied against any amount that was required to be distributed and not done timely. The applies to every year, not just the year in which the RMD is initially required.

While the IRS is generally relatively lenient in waiving these specific penalties the first time generally with the understanding that people when they reach a certain age are not as attuned to these requirements, there is still the cost of doing so. To qualify for penalty abatement the taxpayer needs to remedy problem by withdrawing the amount required and provide an explanation to the IRS why the distribution was missed.

One popular exclusion for taxpayers over age 70-1/2 was that they could make charitable contributions directly from IRA accounts in the amount of the RMD, or greater. Taxpayers who made such contributions would meet the RMD requirement for that year and would be able to exclude the distribution from income.

That exclusion unfortunately expired at the end of 2013. Congress was supposed to reinstate the exclusion but with the loss of in the elections Congress is taking the position that they will punish taxpayers and not enact this provision as well as many other needed extensions relating to business generating tax provisions that were promised prior to the elections.

An alternative is to take the RMD (albeit a taxable one) as required, and then donate the amount thereafter to a charity and take an itemized deduction for a charitable contribution. This is of course subject to the makeup of each individual's tax situation, and should be discussed with us prior to doing so.