Required Minimum Distributions (RMDs)

CONCEPT APPLIED:
Participants in qualified retirement plans and IRAs must begin taking annual distributions equal to or greater than a required minimum amount after age 70½. Hefty penalties apply if the account owner fails to take a withdrawal, or withdraws less than the required amount.

HOW IT WORKS:
The RMD rules apply to all employer-sponsored qualified retirement plans, traditional IRAs and IRA-based plans (but not Roth IRAs). The first RMD is not due until April 1 of the year after an individual turns 70½, but many take it in the year they turn 70½ to avoid taking two distributions in the first year. When an account owner dies, beneficiaries must continue to take RMDs to avoid penalties. RMD distributions are taxed as ordinary income.

50 words or less

Tax deferral doesn't last forever. At some point, the IRS wants its money. In the case of IRAs and qualified retirement plans, federal tax law requires participants to take out a minimum amount annually, usually beginning in the year after they turn 70½.

WHY IS IT USEFUL?
Taking RMDs as required avoids substantial penalties. Plan owners who do not need the money customarily withdraw the minimum amount so the remaining balance can continue to enjoy tax deferral and compound earnings.