

Retirement Plan Distributions

Retirement plans have many requirements regarding distributions, but taxpayers can exercise some authority over plan distributions that might facilitate income tax planning.

For instance, funds in a regular IRA can be accessed without additional early distribution penalties any time after obtaining age 59½. Therefore, anyone meeting the age requirement in 2018 can take a penalty-free distribution from regular IRAs if 2018 income is desired.

Once the IRA owner reaches age 70½, a minimum amount must be distributed from regular IRAs (Roth IRAs are not subject to any minimum distribution requirements) each year. The law allows, but does not require, a small delay of the first required minimum distribution until April 1 of the year after the attainment of age 70½. Therefore, if you reached age 70½ in 2018, you might evaluate the benefit of delayed tax liability on your first distribution compared with the spike in your 2019 taxable income that two distributions in 2019 could cause. Any failure to take the minimum required distributions (MRDs) before the annual deadline causes the IRA owner to owe a 50 percent excise tax on the amount that should have been distributed.

Example: Individual reached age 70½ in 2018 and is required to take a minimum required distribution for the 2018 calendar year. This distribution could be made during 2018 based on the December 31, 2017 IRA balance but the individual waited until April 1, 2019, to take the required amount. Individual must also take a distribution by December 31, 2019, for the 2019 year based on the December 31, 2018, IRA balance, with certain adjustments. Therefore, individual is taxed on two distributions in 2019 which might result in an overall increase in income taxes.

Participants in qualified pension plans who are not 5 percent or more owners of the employer can delay taking distributions out of the plan beyond the minimum required distribution age of 70½ as long as they are still actively employed by the plan sponsor.

If you received a taxable qualified retirement plan distribution that is not a part of a series of substantially equal payments over a specified period of ten years or more, over the life expectancy of the employee or over the joint life expectancies of the employee and the employee's beneficiary, or does not satisfy the minimum required distribution rules, you can generally avoid immediate taxation by "rolling" the money into a regular IRA or other qualified plan. The rollover rules are utilized most often to move retirement funds between IRAs inasmuch as qualified plans are required to withhold 20 percent income tax on distributions made directly to participants. Participants who elect to receive a plan distribution net of the required withholding will have to restore the funds from other sources in order to complete a tax-free rollover of 100 percent of the distribution. If 100 percent of the cash distribution is indeed rolled over within the 60-day timeframe, and 100 percent of the loan distributed in-kind is rolled over before the participant's tax return due date, the distribution is nontaxable.

Example: Employee E retires at age 54 on January 1, 2018, and is entitled to receive a \$100,000 lump-sum distribution from his employer's profit-sharing plan. E does not elect a direct trustee-to-trustee transfer of his \$100,000 to an IRA. At the time of the distribution, the employer must withhold \$20,000 in federal income taxes from the distribution. E receives the remaining \$80,000 on January 10, 2018, and transfers it to an IRA on January 11, 2018.

E will have \$20,000 of gross income, unless he obtains \$20,000 from another source and transfers it to the IRA by March 11, 2018 (within 60 days of receiving the distribution). The \$20,000 will be refunded only after taking into account of all items reported on E's Form 1040 for 2018. In addition, if E fails to transfer the additional \$20,000 to an IRA, E will be liable for the 10 percent early withdrawal penalty on the \$20,000 because E was under age 55 (the minimum age for taking a distribution).