REQUIRED MINIMUM DISTRIBUTIONS

2/28/19

Required Minimum Distributions (RMDs)

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents the types of accounts that are subject to RMDs, how they are calculated and some planning considerations to be aware of when you are required to take these distributions.

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Required Minimum Distributions (RMDs)

Required minimum distributions, often referred to as RMDs or minimum required distributions, are amounts that the federal government requires you to withdraw annually from traditional IRAs and employer-sponsored retirement plans after you reach age 70½ (or, in some cases, after you retire). You can always withdraw more than the minimum amount from your IRA or plan in any year, but if you withdraw less than the required minimum, you will be subject to a federal penalty.

The RMD rules are calculated to spread out the distribution of your entire interest in an IRA or plan account over your lifetime. The purpose of the RMD rules are to ensure that people don't just accumulate retirement accounts, defer taxation, and leave these retirement funds as an inheritance. Instead, required minimum distributions generally have the effect of producing taxable income during your lifetime.

This paper will include a general discussion of the types of accounts that are subject to RMDs, how they are calculated and some planning considerations to be aware of when you are required to take these distributions.

RETIREMENT SAVINGS ACCOUNTS SUBJECT TO THE RMD RULES

In addition to traditional IRAs, simplified employee pension (SEP) IRAs and SIMPLE IRAs are subject to the RMD rules. Roth IRAs, however, are not subject to these rules while you are alive. Although you are not required to take any distributions from your Roth IRAs during your lifetime, your beneficiary will generally be required to take distributions from the Roth IRA after your death.

Employer-sponsored retirement plans that are subject to the RMD rules include qualified pension plans, qualified stock bonus plans, and qualified profit-sharing plans, including 401(k) plans. Section 457(b) plans and Section 403(b) plans are also generally subject to these rules.

HOW ARE RMDS CALCULATED?

RMDs are calculated by dividing your traditional IRA or retirement plan account balance by a life expectancy factor specified in IRS tables. Your account balance is usually calculated as of December 31 of the year preceding the calendar year for which the distribution is required to be made.

Example(s): You have a traditional IRA. Your 70th birthday is November 1 of year one, and you therefore reach age 70½ in year two. Because you turn 70½ in year two, you must take an RMD for year two from your IRA. This distribution (your first RMD) must be taken no later than April 1 of year three. In calculating this RMD, you must use the total value of your IRA as of December 31 of year one.

Caution: When calculating the RMD amount for your second distribution year, you base the calculation on the IRA or plan balance as of December 31 of the first distribution year (the year you reached age 70½) regardless of whether or not you waited until April 1 of the following year to take your first required distribution.

For most taxpayers, calculating RMDs is straightforward. For each calendar year, simply divide your account balance as of December 31 of the prior year by your distribution period, determined under the Uniform Lifetime Table (shown below) using your attained age in that calendar year. This life expectancy table is based on the assumption that you have designated a beneficiary who is exactly 10 years younger than you are. Every IRA owner's and plan participant's calculation is based on the same assumption.

There is one exception to the procedure described above — the younger spouse rule. If your sole designated beneficiary is your spouse, and he or she is more than 10 years younger than you, the calculation of your RMDs may be based on the longer joint and survivor life expectancy of you and your spouse. (The life expectancy factors can also be found in IRS publication 590.) Consequently, if your spouse is your designated beneficiary and is more than 10 years younger than you, you can take your RMDs over a longer payout period than under the Uniform Lifetime Table. If your beneficiary is not your spouse, or a spouse who is not more than 10 years younger than you, then you must use the shorter payout period specified in the Uniform Lifetime Table *(see below)*.

Uniform Lifetime Table

For use by:

- **Unmarried account owners**
- **Married account owner whose spouse is not more than 10 years younger**
- **Married account owner whose spouse is not the sole beneficiary**

Age	Distribution period	Age	Distribution period	Age	Distribution period
70	27.4	85	14.8	100	6.3
71	26.5	86	14.1	101	5.9
72	25.6	87	13.4	102	5.5
73	24.7	88	12.7	103	5.2
74	23.8	89	12.0	104	4.9
75	22.9	90	11.4	105	4.5
76	22.0	91	10.8	106	4.2
77	21.2	92	10.2	107	3.9
78	20.3	93	9.6	108	3.7
79	19.5	94	9.1	109	3.4

80	18.7	95	8.6	110	3.1
81	17.9	96	8.1	111	2.9
82	17.1	97	7.6	112	2.6
83	16.3	98	7.1	113	2.4
84	15.5	99	6.7	114	2.1
				115 and over	1.9

Tip: *In order for the younger spouse rule to apply, your spouse must be your sole beneficiary for the entire distribution year. Your spouse will be considered your sole beneficiary for the entire year if he or she is your sole beneficiary on January 1 of the year and you don't change your beneficiary during the year. In other words, even if your spouse dies, or you get divorced after January 1, you can use the younger spouse rule for that distribution year (but not for distribution years that follow). In the case of divorce, however, if you designate a new beneficiary prior to the end of the distribution year, you cannot use the younger spouse rule (since your former spouse will not be considered your sole beneficiary for the entire year).*

If you have multiple IRAs, an RMD is calculated separately for each IRA. However, you can withdraw the required amount from any one or more IRAs. Inherited IRAs are not included with your own for this purpose. If you participate in more than one employer retirement plan, your RMD is calculated separately for each plan and must be paid from that plan, except for 403(b) Plans, which allow for the RMD to be withdrawn from one when you have multiple 403(b) accounts.

WHEN MUST RMDS BE TAKEN?

Your first required distribution from an IRA or retirement plan is for the year you reach age 70½. However, you have some flexibility as to when you actually have to take this first-year distribution. You can take it during the year you reach age 70½, or you can delay it until April 1 of the following year.

Since this first distribution generally must be taken no later than April 1 following the year you reach age 70½, this April 1 date is known as your required beginning date. Required distributions for subsequent years must be taken no later than December 31 of each calendar year until you die or your balance is reduced to zero. This means that if you opt to delay your first distribution until April 1 of the following year, you will be required to take two distributions during that year — your first year's required distribution and your second year's required distribution.

Example: *You have a traditional IRA. Your 70th birthday was December 2, 2018, so you will reach age 70½ in 2019. You can take your first RMD during 2019, or you can delay it until April 1, 2020. If you choose to delay your first distribution until 2020, you will have to take two required distributions during 2020 — one for 2019 and one for 2020. This is because your required distribution for 2020 cannot be delayed until the following year.*

Some confusion has existed around specific birthdays that fall in the middle of the year as it relates to determining when exactly those individuals turn 70 ½. The following examples can clarify those circumstances.

If you were born on June 30, 1948, your 70th birthday is June 30, 2018. You'll reach age 70½ on December 30, 2018. You can either take your first distribution in 2018 (the year you reach age 70½) or delay it until the following April (April 1, 2019). Your second RMD is required by December 31, 2019.

However, if your birthday was July 1, 1948, you'll reach age 70 on July 1, 2018, and age 70½ on January 1, 2019. You can take your first distribution in 2019 (the year you'll reached age 70½) or delay it until the following April 1 (April 1, 2020). In this example, your second RMD is required by December 31, 2020.

There is one situation in which your required beginning date can be later what has been described above. If you continue working past age 70½ and are still participating in your employer's retirement plan, your required beginning date under the plan of your current employer can be as late as April 1 following the calendar year in which you retire (if the retirement plan allows this and you own 5% or less of the company). Again, subsequent distributions must be taken no later than December 31 of each calendar year.

Examples: *You own more than 5% of your employer's company and you are still working at the company. Your 70th birthday was on December 2, 2018, meaning that you will reach age 70½ in 2019. You must take your first RMD from your current employer's plan by April 1, 2020 — even if you're still working for the company at that time, because you own more than 5% of the company.*

You participate in two plans — one with your current employer and one with your former employer. You own less than 5% of each company. Your 70th birthday was on December 2, 2018 (so you'll reach 70½ on June 2, 2019), but you'll keep working until you turn 73 on December 2, 2021. You can delay your first RMD from your current employer's plan until April 1, 2022 — the April 1 following the calendar year in which you retire. However, as to your former employer's plan, you must take your first distribution (for 2019) no later than April 1, 2020 — the April 1 after reaching age 70½.

PLANNING CONSIDERATIONS FOR DELAYING YOUR FIRST RMD

As described above, you have the option of delaying your first distribution until April 1 following the calendar year in which you reach age 70½ (or April 1 following the calendar year in which you retire, in some cases).

You might delay taking your first distribution if you expect to be in a lower income tax bracket in the following year, perhaps because you are no longer working or will have less income from other sources. However, if you wait until the following year to take your first distribution, your second distribution must be made on or by December 31 of that same year.

Receiving your first and second RMDs in the same year may not be in your best interest. Since this "double" distribution will increase your taxable income for the year, it may cause you to pay more in federal and state income taxes. It could even push you into a higher federal income tax bracket for the year. In addition, the increased income may cause you to lose the benefit of certain tax exemptions and deductions that might otherwise be available to you. So the decision of whether to delay your first required distribution can be important, and should be based on your personal tax situation.

Example(s): *You are single and reached age 70½ in 2018. You had taxable income of $25,000 in 2018 and expect to have $25,000 in taxable income in 2019. You have money in a traditional IRA and determined that your RMD from the IRA for 2018 was $50,000, and that your RMD for 2019 is $50,000 as well. You took your first RMD in 2018. The $50,000 was included in your income for 2018, which increased your taxable income to $75,000. At a marginal tax rate of 22%, federal income tax was approximately $12,439 for 2018 (assuming no other variables). In 2019, you take your second RMD. The $50,000 will be included in your income for 2019, increasing your taxable income to $75,000 and resulting in federal income tax of approximately $12,358. Total federal income tax for 2018 and 2019 will be $24,797.*

Now suppose you did not take your first RMD in 2018 but waited until 2019. In 2018, your taxable income was $25,000. At a marginal tax rate of 12%, your federal income tax was $2,596 for 2018. In 2019, you take both your first RMD ($50,000) and your second RMD ($50,000). These two $50,000 distributions will increase your taxable income in 2019 to $125,000, taxable at a marginal rate of 24%, resulting in federal income tax of approximately $22,956. Total federal income tax for 2018 and 2019 will be $25,552 — $755 more than if you had taken your first RMD in 2018.

Since your ultimate tax liability will likely be based on a few to several other items of income, deductions, and any available tax credits in a given year, it is important to look at all factors when determining if delaying your first RMD makes sense. Generally speaking, if your tax situation for the year you turn 70½ and the following year are expected to be similar, then it is typically advisable to take the RMD in the year you turn 70 ½ and take your second RMD in the following year. It's important to look at your individual situation to see what option produces the most favorable outcome.

WHAT IF YOU FAIL TO TAKE RMDS AS REQUIRED?

You can always withdraw more than you are required to from your IRAs and retirement plans. However, if you fail to take at least the RMD for any year (or if you take it too late), you will be subject to a federal penalty. The penalty is a 50% excise tax on the amount by which the RMD exceeds the distributions actually made to you during the taxable year.

Example: *You own one traditional IRA and compute your RMD for year one to be $7,000. You take only $2,000 as a year-one distribution from the IRA by the date required. Since you are required to take at least $7,000 as a distribution but have only taken $2,000, your RMD exceeds the amount of your actual distribution by $5,000 ($7,000 minus $2,000). You are therefore subject to an excise tax of $2,500 (50% of $5,000).*

Technical Note: *You report and pay the 50% tax on your federal income tax return for the calendar year in which the distribution shortfall occurs. You should complete and attach IRS Form 5329, "Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts." The tax can be waived if you can demonstrate that your failure to take adequate distributions was due to "reasonable error" and that steps have been taken to correct the insufficient distribution. You must file Form 5329 with your individual income tax return, and attach a letter of explanation. The IRS will review the information you provide and decide whether to grant your request for a waiver.*

Missing an RMD carries a 50% penalty on the amount not withdrawn. In reality though, almost no one ever pays that penalty. The IRS allows it to be waived for good reason. Early in 2019, before the 2018 tax return is prepared, is the time to do a review and see if any 2018 or prior year RMDs were missed. This also applies to IRAs that have been inherited and inherited Roth IRAs. Roth IRA owners are not subject to RMDs but inherited Roth IRA owners are.

If you have multiple IRAs, the RMD must be calculated for each IRA owned, however, the total amount of all the RMDs may be withdrawn from one (or more) of the IRAs. Note, however, if you also have an employer sponsored retirement plan, such as a 401(k), when you reach your RMD age, you must calculate the RMD separately from that retirement plan and the RMD must be withdrawn from that specific plan. The RMD rules also apply to employer sponsored retirement plans with a Roth option, even though RMDs do not apply to Roth IRAs for the account owner. Additionally, an RMD may not be rolled into another tax-deferred account.

CAN YOU SATISFY THE RMD RULES WITH THE PURCHASE OF AN ANNUITY CONTRACT?

Your purchase of an annuity contract with the funds in your IRA or retirement plan satisfies the RMD rules if all of the following are true:

- Payments are made at least yearly
- The annuity is purchased on or before the date that distributions are required to begin
- The annuity is calculated and paid over a time period that does not exceed those permitted under the RMD rules
- Payments, with certain exceptions, do not increase

If you participate in a 401(k) (or similar plan) or an IRA, you may also be able to use up to 25% of your account balances (up to a maximum of $130,000 from all accounts, indexed for inflation) to purchase a qualifying longevity annuity (or QLAC). The value of the QLAC is disregarded when you calculate the amount of RMDs you are otherwise required to take from your account each year. Payments from the QLAC can be delayed up to age 85, and are treated as satisfying the RMD rules when paid. The rules can be complicated, and QLACs are not right for everyone, so be sure to consult a qualified professional for further information.

QUALIFIED CHARITABLE DISTRIBUTIONS

A Qualified Charitable Distribution (QCD) is a direct transfer of funds from an IRA to a qualified charity. A benefit of QCDs is that they can be counted towards your RMD for the year, provided that certain requirements are met. An additional benefit of QCDs is that the amount donated directly to the charity from an IRA is excluded from taxable income.

Furthermore, using a QCD does not require that you itemize deductions, making it possible to use the higher standard deduction, while still using a QCD to donate to charity. Recent tax law changes that will likely have many more taxpayers using the standard deduction, instead of itemizing deductions, may bring increased appeal to QCDs since regular charitable deductions require that you itemize your deductions on Schedule A, under current tax laws.

To make a Qualified Charitable Distribution, you must be 70½ or older. An individual can contribute up to $100,000 per year in QCDs. For married couples, each spouse can make QCDs up to the $100,000 limit, for a total of $200,000. The $100,000 per person limit applies to the sum of all QCDs taken from all IRAs in a year. A donor can make one large contribution or several smaller contributions over the course of the calendar year. [1]

QCDs can be made from traditional IRA, inherited IRA, inactive Simplified Employee Pension (SEP) plan and inactive Savings Incentive Match Plan for Employees (SIMPLE) IRAs. (Inactive SEP and SIMPLE IRAs are accounts that no longer receive employer contributions in the year that the QCD was made).

The charity must be a 501(c)(3) organization, eligible to receive tax-deductible contributions. Note that under current tax law, private foundations and donor advised funds do not qualify for QCDs.

Charitable distributions are reported on Form 1099-R for the calendar year the distribution is made. To report a qualified charitable distribution on your Form 1040 tax return, you generally report the full amount of the charitable distribution on the line for IRA distributions. On the line for the taxable amount, enter zero if the full amount was a qualified charitable distribution. Enter "QCD" next to this line. See the Form 1040 instructions for additional information.

You must also file Form 8606, Nondeductible IRAs, if:

- You made the qualified charitable distribution from a traditional IRA in which you had basis and received a distribution from the IRA during the same year, other than the qualified charitable distribution; or
- The qualified charitable distribution was made from a Roth IRA. [2]

TAX CONSIDERATIONS

INCOME TAX:

Like other distributions from traditional IRAs and retirement plans, RMDs are generally subject to federal (and possibly state) income tax for the year in which you receive the distribution. However, a portion of the funds distributed to you may not be subject to tax if you have ever made after-tax contributions to your IRA or plan.

For example, if some of your traditional IRA contributions were not tax deductible, those contribution amounts will be income-tax-free when you withdraw them from the IRA. This is simply because those dollars were already taxed once. You should consult a tax professional if your IRA or plan contains any after-tax contributions.

Your distribution may also be income-tax-free if it is a qualified distribution from a Roth 401(k), 403(b), or 457(b) account. Generally, an RMD is qualified if your Roth account satisfies a five-year holding

[1] Fidelity Charitable Donor-Advised Fund. (n.d.). Retrieved February 28, 2019, from http://www.fidelitycharitable.org/

[2] Internal Revenue Service | An official website of the United States government. (n.d.). Retrieved February 28, 2019, from http://www.irs.gov/

period requirement. If your RMD is not qualified, then generally only the portion of the RMD paid from your Roth account that represents earnings will be taxable to you — your own contributions to the Roth account are returned tax free.

Because RMDs are paid after you turn age 70½, or after your death, they are not subject to early distribution penalties. Income taxes on RMDs paid to your beneficiary after your death are generally calculated in the same manner as if the payments were made to you.

Caution: *Taxable income from an IRA or retirement plan is taxed as ordinary income tax rates even if the funds represent long-term capital gain or qualifying dividends from stock held within the plan. Note that there are special rules for capital gain treatment in some cases on distributions from employer-sponsored plans.*

ESTATE TAX:

You first need to determine whether or not the federal estate tax will apply to you. If you do not expect the value of your taxable estate to exceed the federal applicable exclusion amount then federal estate tax may not be a concern for you. However, state death (or inheritance) tax may be a concern. In some cases, your assets may be subject to more than one type of death tax — for example, the generation-skipping transfer tax may also apply. Consider getting professional advice to establish appropriate strategies to help reduce and possibly eliminate your future estate tax liability.

For example, you might reduce the value of your taxable estate by gifting all or part of your required distribution to your spouse or others. Making gifts to your spouse can sometimes work well if your taxable estate is larger than your spouse's, and one or both of you will leave an estate larger than the applicable exclusion amount. This strategy can provide your spouse with additional assets to better utilize his or her applicable exclusion amount, thereby minimizing the combined estate tax liability of you and your spouse. Be sure to consult an estate planning attorney, however, about this and other possible strategies.

Caution: *In addition to federal estate tax, your state may impose its own estate or death tax. Consult an estate planning attorney for details.*

INHERITED IRAS AND RETIREMENT PLANS

Your RMDs from your IRA or plan will cease after your death, but your designated beneficiary (or beneficiaries) will then typically be required to take minimum distributions from the account. A spouse beneficiary may generally roll over an inherited IRA or plan account into an IRA in the spouse's own name, allowing the spouse to delay taking additional required distributions until he or she turns 70½.

As with required lifetime distributions, proper planning for required post-death distributions is essential. You should consult an estate planning attorney and/or a tax professional.

CONCLUDING THOUGHTS

There are many rules surrounding RMDs and it's important to look at how these RMDs fit within your overall retirement income plan. Planning for RMDs can begin well before you reach the age at which RMDs begin. For example, converting assets from your Traditional IRA to a Roth IRA through Roth Conversions for several years prior to reaching age 70½ may serve to decrease your RMDs. You also may benefit from using the Qualified Charitable Distribution, described above, to satisfy your RMD while reducing taxable income. Everyone's retirement income strategy will be different and it's important to view RMDs within the context of your comprehensive financial plan.

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We are here to help.

Sincerely,

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