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THE DEFINITIVE GUIDE TO REQUIRED MINIMUM DISTRIBUTIONS FOR BABY BOOMERS

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During their working years, most people are focused on accumulating assets for use later in life. Retirement accounts, due to their tax-favored nature and widespread availability, are logical choices through which to accumulate much of that savings.

In some cases, people are lucky enough to have sufficient income from other areas, such as a pension, investment income from non-retirement accounts and/or Social Security benefits, to avoid taking distributions from their retirement accounts during their initial years of retirement. By doing so, a retirement account owner can avoid including any retirement account distributions in their income, thereby minimizing the tax impact (Note: this may or may not produce the most tax efficient result over the long-term).

Eventually however, there *will* come a time when Uncle Sam will say "*no more*," and individuals will be forced to begin taking distributions from their retirement accounts, whether they want to or not. This day of reckoning even has its own special name, the **"required beginning date."** Once required minimum distributions (RMDs) begin, they continue for the remainder of an individual's lifetime or until they run out of retirement account funds.

Any missed RMD or shortfall is subject to a 50% penalty.

Proper understanding of the RMD rules by advisors is a necessity for several reasons. For starters, it's one aspect of retirement distribution planning that impacts nearly all clients at one point or another. Plus, messing up the RMD rules can have some serious consequences for a client. Any missed RMD or shortfall (the difference between what a client was supposed to take as an RMD and what they actually took) is subject to a **50% penalty.** That is *not* a typo.

RMD planning will take on even greater importance this year (2016). The very first Baby Boomers to be subject to RMDs for their own retirement accounts will have to take an RMD for 2016. Having about 10,000 Baby Boomers still turning 65 every day means that a lot of people are about to deal with RMDs. And unfortunately, that probably means a lot of people are about to make a lot of very costly errors.

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The Required Beginning Date

The required beginning date (RBD) for an IRA owner is April 1 of the year *following* the year they turn age 70 ½. For example, if an IRA owner turns age 70 ½ on January 1, 2016, their RBD is April 1, 2017. Similarly, if an IRA owner turns age 70 ½ on December 31, 2016, their RBD is also April 1, 2017. The RBD is the absolute **last** date that a person can begin taking minimum distributions from their retirement account without being subject to a penalty.

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However, the required beginning date is more than just the date when required minimum distributions must be taken for retirement account owners. It's also a key date for determining how quickly post-death distributions must be taken from a retirement account if the owner dies without a designated beneficiary.

> *Note: If an IRA owner dies before their RBD and without a designated beneficiary, the inherited IRA must be emptied by no later than the end of the fifth year after the year-of-death. If an IRA owner dies on or after their RBD and without a designated beneficiary, the inherited IRA must be distributed over the decedent's remaining single life expectancy, had they lived.*

April 1 of the year following the year a person turns age 70 ½ is the RBD for all IRA owners (other than for Roth IRAs, which have no required minimum distributions during the Roth IRA owner's lifetime). This includes traditional IRAs, as well as SEP IRAs and SIMPLE IRAs. It is also *generally* the required beginning date for employer-sponsored retirement plans, although some exceptions apply.

The "Still Working" Exception

For the most part, clients are retired by the time they reach age 70 ½, but occasionally they enjoy their job enough (or need the income badly enough) to continue working beyond that age. In such cases, the client *may* be able to continue delaying required minimum distributions until the year they retire. If the following conditions are present, an employee's RBD is the latter of April 1 of the year following the year they turn age 70 ½ (as discussed above) or April 1 of the year after they separate from service with the employer sponsoring the applicable plan:

- **The client is still working -** Somewhat surprisingly, there is no formal definition of "still working" in either the tax code or the regulations. So, if a client is still treated as an employee of the company even though they only work, say, one day a month, it appears they could meet the definition of "still working" and avoid RMDs until they completely retire.

- **The client does not own more than 5% of the company -** If a client is still working, but owns more than 5% of the company for which they are working, the still working exception does **not** apply, and required minimum distributions must begin by April 1 of the year following the year they turn age 70 ½.

  Here's something else to consider that **almost no one seems to know**. The 5% ownership hurdle doesn't just count the plan participant's own stake in the company. It also includes certain other family member's ownership percentages, such as a spouse or children.

  > **Example: Harold and Diane are married and are each 72 years old. Both own 3% of ABC Corporation and have 401(k) balances in the ABC Corporation. Harold still works 30 hours per week, but Diane has retired. Despite the fact that Harold is still working and does not personally own more than 5% of ABC Corporation, he must take an RMD from his ABC Corporation 401(k) because, combined, he and his wife own 6% (more than 5%) of the company.**

- **The plan allows for the still working exception -** Although many plans today have incorporated the still working exception, there is no requirement that they do so. Instead, a plan can require all employees to begin distributing assets no later than April 1 of the year following the year they turn age 70 ½, regardless of whether they own 5% or less of the company.

- **The still working exception only applies to a plan sponsored by the company for whom the employee is still working –** Suppose your client is working for ABC Company beyond age 70 ½ and participates in the ABC Company 401(k) plan. In addition, they also have two 401(k)s from past employers. All three 401(k)s allow the still working exception and your client is not more than a 5% owner of any of the businesses. In this situation, your client could only defer taking RMDs from the ABC Company 401(k) plan, since that's the only company for which they are still working.

If a client is still working, but owns more than 5% of that company, the still working exception does not apply.

Strategy to Delay RMDs for All Retirement Accounts

If your client is still working or intends to still be working beyond age 70 ½, they are not more than a 5% owner of the company for which they are working, and their employer-sponsored retirement plan allows the still working exception, there *may* be a way for the client to delay RMDs on **all** of their retirement account assets.

If this is something that might appeal to your client, you should check and see if their employer-sponsored retirement plan also allows them to roll in funds from other retirement accounts. If it does, then it appears that once those other funds have been rolled into the client's plan, RMDs can be deferred on those amounts as well until the client separates from service.

> *Note: If the client will be age 70 ½ or older in the year their other retirement account funds are rolled into the plan with the still working exception, they must first take their required minimum distribution from those other accounts prior to making the rollover. A required minimum distribution cannot be rolled over, even if the rollover is a direct rollover.*

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A quick word of caution about the strategy… There is nothing in the tax code or regulations that specifically confirms this strategy. It appears to work, though, and there is no published guidance to the contrary. To be safe, however, if you're not a tax professional, then it's probably best to get the blessing of your client's CPA or tax advisor before you utilize this strategy, especially if you're one of those advisors that must provide an *"I don't give tax advice"* disclaimer on just about anything you hand out.

The "Old Money" Exception for 403(b)s

Another way a client may be able to defer RMDs past age 70 ½ is if they have 403(b) money that contains what's colloquially referred to as "old money." This is another one of those obscure provisions in the tax code that is more of a relic of the past than anything else, and exists only to grandfather in the treatment of certain retirement account assets attributable to participation in a 403(b) plan prior to 1987. Using the old money exception, a 403(b) participant can defer taking RMDs on the pre-1987 portion of their retirement savings until the year they turn age 75. In order to utilize this exception, the following conditions must be met:

- **The plan must be a 403(b) plan.**

- **The exception applies only to amounts accumulated as of December 31, 1986 –** This exception is very specific and literally applies only to the exact pre-1987 balance a client had accumulated in their 403(b). Any earnings attributable to those amounts since that point in time do not get the same treatment, and like all the other non-pre-1987 assets in the client's 403(b) plan, they follow the "regular" RMD rules (distributions must generally begin by April 1 of the year following the year the client turns age 70 ½).

  Some older 403(b) participants, particularly teachers, are hesitant to roll over their 403(b) funds to an IRA (or other retirement plan), because they think the "old money" exception provides a significant benefit (for instance, many believe the exception applies to their entire 403(b) balance). Rarely is that the case. For that reason, the "old money" exception does not typically play a major role in whether or not a client should execute a rollover.

- **The plan must have kept track of the pre-1987 balance –** In many cases, this total will be readily available on a client's statement. In other cases, a plan will still have kept track of this amount somewhere. Make a phone call to the plan administrator to find the applicable balance.

- **Any voluntary distributions taken by a client are first attributable to their pre-1987 balance –** As such, voluntary distributions reduce the amount of a 403(b) participant's plan balance that is eligible for the old money exception.

Required Minimum Distributions... Way More Than Meets the Eye

You wouldn't think that calculating a required minimum distribution would be that hard. After all, it would appear at first glance to be a matter of simple math. Just take the balance in a client's retirement account at the end of the prior year and divide it by their appropriate life expectancy factor. If it were only that easy.

The reality is that calculating RMDs is actually far more complicated than most people realize. To make matters worse, even if you calculate the right RMD, taking the right amount from the right account or type of account can sometimes be just as challenging.

Plus, if you think your client's custodian has taken care of this, think again! Although IRA custodians are required to calculate or offer to calculate a client's RMD upon request, they don't actually have to calculate it correctly.

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That's because there are any number of adjustments that may need to be made to a client's year-end balance or life expectancy factor that a custodian does not have to take into consideration when they make their RMD calculation – *more on that in a bit.* Plus, at the end of the day, a person is always responsible for their own retirement account. The IRS website even has this to say about the issue:

> ***Who calculates the amount of the RMD?***
> ***Although the IRA custodian or retirement plan administrator may calculate the RMD, the IRA or retirement plan account owner is ultimately responsible for calculating the amount of the RMD.***

From the IRS webpage ***Retirement Plans FAQs regarding Required Minimum Distributions***

View this Q&A in your web browser.

Calculating a Client's RMD – Selecting the Right Life Expectancy Factor

The first step in making sure that a client's required minimum distribution is calculated correctly is choosing the right "life expectancy factor." As a general rule, retirement account owners determine their appropriate life expectancy factor using the *Uniform Lifetime Table*, provided on the following page.

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Uniform Lifetime Table

Age of IRA Owner or Plan Participant	Life Expectancy (In Years)	Age of IRA Owner or Plan Participant	Life Expectancy (In Years)
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115+	1.9

To select the right life expectancy factor, a client uses the factor that corresponds to their age as of the end of the year for which they are doing the calculation. For example, if your client was calculating her required minimum distribution for 2016, she would look up her life expectancy factor using her age on December 31, 2016. If she turned 76 on October 12, 2016, she would use 22.0 as her life expectancy factor, regardless of when she took her distribution during the year. So, even if she took her 2016 required minimum distribution while she was only 75, the distribution would still be calculated using the factor for a 76-year-old.

The following year, your client would use 21.2 as her life expectancy factor, the factor for a 77-year-old. The year after that, she would use 20.3 as her life expectancy factor, the factor for a 78-year-old… and so on. Note that each year a client returns to the table to find their new factor.

The phrase "life expectancy factor" isn't part of a client's everyday vernacular, though, and clients simply don't speak in such terms. Instead, when clients think about how much needs to come out of their retirement account to satisfy an RMD, they generally think in terms of either dollar amounts or percentages. Obviously, there's no standard template or information you can provide regarding the dollar amount a client must distribute from their retirement account to satisfy an RMD, as it will obviously vary greatly from situation to situation. On the other hand, if you know the age of your client, you can at least provide some standard information about the percentage that must be withdrawn from their retirement account to satisfy their RMD.

With that in mind, the chart on the following page provides a breakdown of the Uniform Lifetime Table life expectancy factors expressed as a percentage. To calculate a client's RMD using that table, you simply multiply the client's prior year-end account balance by the applicable percentage as determined by their age at the end of the year.

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Uniform Lifetime Table by Percent

The Full Table is Available in the Complete Guide

Age of IRA Owner or Plan Participant	RMD as a % of Account Balance*	Age of IRA Owner or Plan Participant	RMD as a % of Account Balance*
70	3.65%	79	5.13%
71	3.78%	80	5.35%
72	3.91%	81	5.59%
73	4.05%	82	5.85%
74	4.21%	83	6.14%
75	4.37%	84	6.46%
76	4.55%	85	6.76%
77	4.72%	86	7.10%
78	4.93%	87	7.47%

**Note: All RMD percentages are rounded up to the nearest hundredth percent to ensure that clients do not have a shortfall with regard to an RMD*

The Baby Boomer Wave is About to Take RMDs

2.5 2.5 Million Baby Boomers Reach Age 70 This Year

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