Is it time to cash in on your retirement savings?

Be sure you understand the rules and possible tax consequences of taking IRA and retirement plan distributions.

Whether your retirement is close or still a ways off, you may be ready—or required—to put your savings to use.

With a retirement plan, you must satisfy certain requirements before taking a distribution, but with an IRA, you can withdraw your IRA assets anytime (subject to possible tax and penalty).

Ideally, you will be able to start drawing from your retirement savings around the time you retire, but there may be reasons for accessing the funds sooner. And once you reach age 70½, you may be required to start withdrawing money from these plans. Required minimum distributions (RMDs) are a must for the following types of accounts.

- ☑ Traditional IRAs (including those with SEP plan contributions)
- ☑ SIMPLE IRAs
- ☑ Qualified retirement plans

Consider visiting with your competent tax or financial advisor before taking IRA or retirement plan distributions.

Each type of retirement savings account has its own rules for taking distributions.

Traditional and SIMPLE IRA

You generally must include any Traditional and SIMPLE IRA distribution amounts in your income for the year of the distribution. Traditional IRA assets are distributed pro rata, meaning that a portion of both deductible and nondeductible assets make up every distribution you take if you've made nondeductible IRA contributions. But any nondeductible contributions will not be taxed when taken out.

If you are under age 59½ when you take the distribution, you will be subject to an early distribution penalty on the taxable amount of the distribution, unless you qualify for an exception (see IRS Publication 590-B for penalty tax exceptions).

Roth IRA

When you take a distribution from your Roth IRA, the assets are deemed to be distributed in a certain order: contribution amounts, then conversion or retirement plan rollover amounts (excluding designated Roth assets), then the earnings. You do not have to include any contribution or conversion/rollover amounts in your income for the year of the distribution. But you may need to include the earnings in your income.

If you are under age 59½ when you take the distribution and the distribution is not "qualified," part of the distribution may be subject to the early distribution penalty tax.

If the Roth IRA distribution is "qualified," then no taxes or penalties apply, not even on the earnings. To be a qualified distribution, you must have owned a Roth IRA for at least five years AND be age 59½ or older, disabled, or a first-time homebuyer. Roth IRA beneficiaries also may take qualified distributions if inheriting from someone who has had a Roth IRA for at least five years.

Qualified Retirement Plan

If you've been participating in a qualified employer-sponsored retirement plan, such as a 401(k) plan, you must satisfy a triggering event described within the plan document before you can withdraw money from the plan. Triggering events vary, but common triggers are termination of employment, normal retirement age, death, disability, and plan termination.

Some profit sharing plans, including 401(k) plans, allow plan participants to take in-service or hardship distributions without a triggering event.

Distributions of pretax salary deferrals, employer contributions, and earnings are taxable in the year distributed. And, if a distribution is eligible for rollover but paid to you, your employer must withhold 20 percent of the taxable portion of the distribution and remit it to the IRS. Additional rules apply to distributions of designated Roth 401(k) assets.

If you take a taxable distribution before you turn age 59½, you will owe a 10 percent early distribution penalty tax—unless you qualify for an exception (death, disability, medical care, separation from service at age 55 or later, etc.). Note that early distribution penalty tax exceptions are different than triggering events.

RMDs

If you have a Traditional IRA, SIMPLE IRA, or qualified retirement plan, you generally must begin taking RMDs the year you turn age 70½, which may be the same year you turn 71, depending on when your birthday falls.

If you're an IRA owner, your financial organization should notify you by January 31 that you have an RMD due for the year. The financial organization will also inform the IRS of this. If you're a plan participant, your plan administrator will have its own procedure for notifying you about RMDs.

The deadline to take your first IRA RMD is April 1 of the year following the year you reach age 70½. For a qualified retirement plan, it is generally April 1 of the year following the year you reach age 70½ or retire from service with the employer maintaining your plan, whichever is later. RMDs for years after your 70½ year must be taken by December 31 each year.

Your RMD generally is determined by dividing your prior year-end account balance by your life expectancy factor, which is based on one of the IRS life expectancy tables found in IRS Publication 590-B. It is the minimum amount that you must take each year. You can always take more than the RMD amount.

If you own more than one IRA you may take the total of all of your IRA RMDs from one IRA, provided you've calculated the RMD for each IRA separately. You cannot aggregate qualified retirement plan RMDs.

You generally must include RMD amounts in your taxable income for the year that you take them. Not taking RMDs could result in an additional IRS penalty tax.

For More Information

We'd be happy to answer your IRA and retirement plan distribution questions.