Be Careful to Get the Withdrawal Rules Right for 2022 or Face Penalties

Retirement Plans and RMDs

by Alexandra Armstrong, CFP, CRPC, and Christopher Rivers, CFP, CRP

One of the most frequently asked questions we receive from clients is how to handle the required minimum distributions (RMDs) from their individual retirement accounts (IRAs) and company retirement plans. The maze of requirements around the calculation, the timing and the coordination of distributions can be like learning a whole new language. Thus, even those who have settled into a routine should revisit rules and their plan for 2022.

Given recent changes and the consequences of getting something wrong, we thought now is a good time to review RMDs and discuss potential planning strategies.

What Assets Are Subject to Required Minimum Distributions Rules?

If you own an IRA, SEP IRA or SIMPLE IRA, you must take your RMD for the year in which you reach age 72. Prior to 2020, RMDs began at age 70½. The requirement also applies to 401(k), 403(b) and 457(b) employer retirement plans if you are not currently working for the employer that sponsored the plan. If you are still working past age 72 and have an employer-sponsored plan, you have different requirements, which we discuss in greater detail below. Lastly, the RMD rules do not apply to Roth IRA and Roth 401(k) accounts.

When Must RMDs Begin?

You must take an RMD from any of the accounts mentioned above once you turn 72. There is a provision that allows you to take your first RMD as late as April 1 of the year after the year you reach age 72, however. After that, you must take your RMD by Dec. 31 of each calendar year. Note that waiting until April 1 to take your first RMD may result in an undue tax burden, as you'd have to take your age 72 and age 73 RMDs in the same calendar year, doubling the taxable income distributed in one tax year.

How Are RMDs Calculated?

The amount you have to withdraw is determined by dividing the prior year-end value of your retirement accounts by a life-expectancy factor supplied by the IRS. The Uniform Life Expectancy Table (*see table on next page*) is used by most people who take RMDs. You start by looking up the age you will be on Dec. 31 of the current year and the corresponding life-expectancy factor.

From there, you take the value of your retirement accounts at the most recent year-end and divide it by the factor on the table to determine the amount you're required to withdraw.

For example, if Lisa turns 77 in August 2022, she would divide the value of her retirement accounts on Dec. 31, 2021, by 22.9, which is the factor for age 77. If her IRA was worth $200,000 on Dec.. 31, 2021, her RMD for 2022 will be $8,733.63.

This table was updated for 2022 to reflect the fact that we are all living longer. The Internal Revenue Service reduced the factors and thus the amounts you are required to take each year. Under the old table Lisa would have been required to draw $9,433 in 2022.

How Do You Meet the Requirements?

The RMD requirements apply to any and all retirement accounts you own, once you reach 72 (with some exceptions noted below). If you have three IRA accounts, you will calculate your RMD using the Dec. 31 value for all three accounts. The IRS requires you to take the total amount calculated, but they don't require you to take an RMD from each individual IRA account.

For example, if you have one IRA with an RMD of $7,200, and another IRA with a RMD of $600 for 2022, you may take the entire $7,800 from the larger IRA and this will meet the requirement for 2022.

However, this approach doesn't apply to employer-sponsored plans like 401(k)s. If you have two IRAs, plus an old 401(k) plan, you must calculate the RMD on all three accounts. In this example, you can withdraw the IRA distributions from one IRA account, but you must take the 401(k) plan RMD from the 401(k).

When it comes to RMD rules, ignorance is not bliss. If you fail to withdraw the minimum required amount each year, you will be subject to an IRS penalty of 50% of the amount you should have withdrawn. In the example above, if Lisa forgot to distribute $8,733 in 2022, she would need to take out $8,733 in 2023, plus pay an additional 50% penalty of $4,366 to the IRS.

How Are RMDs Taxed?

RMDs are taxed in the year you receive them. If you've ever made nondeductible contributions to a traditional IRA, a portion of each RMD will be tax-free. For each year you made a nondeductible contribution, you should have filed Form 8606 showing the cumulative amount of nondeductible contributions made to your IRAs. This same form is used to calculate the tax-free portion of each of your RMDs.

Unfortunately, income taxes cannot be minimized by

withdrawing only from the nondeductible IRA. The IRS considers all traditional IRAs to be one account when figuring how much of the withdrawal is taxable.

Special Situation I — Inherited IRAs

If you inherit an IRA from your spouse, you have a special opportunity that other beneficiaries don't have. As a spouse, you can roll the account over into an IRA in your name — either an existing IRA or a newly created one.

If the deceased spouse was over 72, then the RMD based on the deceased's age must be fulfilled in the year of death. If the RMD has not been completed before the date of death, it's the obligation of the spouse to take a distribution by year-end, even if the spouse is younger than age 72. In future years, the surviving spouse would follow the RMD rules that apply to his or her own retirement accounts, based on his or her own age.

For those who inherit an IRA from someone other than a spouse, the rules changed significantly at the end of 2019. Previously, if you inherited an IRA from a parent, sibling or other non-spouse, you were required to take an RMD each year, regardless of whether you or they had reached age 72. The SECURE Act passed by Congress in December 2019 eliminated this so- called "stretch IRA."

Beneficiaries are now required to withdraw the entire inherited retirement account within 10 years of the original owner's death. The beneficiary does have the flexibility to decide as to when the money is withdrawn within that 10-year period. Thus, there can be the opportunity for careful tax planning about timing as to when you realize the income from the inherited IRA.

There are some exceptions to this rule. The individuals who remain entitled to the lifetime "stretch" option include disabled or chronically ill individuals, as well as an individual who is not more than 10 years younger than the deceased. Children have until 10 years after they reach the age of majority to withdraw the full amount.

Lastly, in a confusing twist, while Roth accounts aren't subject to regular RMDs, these rules do apply to inherited Roth IRAs and Roth 401(k)s if you inherit them from a non-spouse.

The Uniform Life Expectancy Table

Age of IRA Owner or Plan Participant	Life Expectancy (in years)	Age of IRA Owner or Plan Participant	Life Expectancy (in years)
72	27.4	**87**	14.4
73	26.5	**88**	13.7
74	25.5	**89**	12.9
75	24.6	**90**	12.2
76	23.7	**91**	11.5
77	22.9	**92**	10.8
78	22.0	**93**	10.1
79	21.1	**94**	9.5
80	20.2	**95**	8.9
81	19.4	**96**	8.4
82	18.5	**97**	7.8
83	17.7	**98**	7.3
84	16.8	**99**	6.8
85	16.0	**100**	6.4
86	15.2	Full table goes…	to age 126

Special Situation II — a Younger Spouse

If your spouse is more than 10 years younger than you, there is a second table that is used to calculate your RMD, instead of the Uniform Life Expectancy Table provided here. This second table is known as the Joint Life Expectancy Table. This table accounts for the potential longer total life expectancy between the two of you. Other than the factor involved, the process for calculating the RMD is the same.

Special Situation III — a 401(k) Plan While Still Working

If you own a qualified retirement plan such as a 401(k), the RMD rules generally apply in the same way, with one exception. If you're still working at the company that sponsored the plan past age 72, and you own less than 5% of that company, you don't have to take RMDs from that plan until April 1 of the year after the year you retire. Again, this only applies to the current company and plan. If you are still working, and have old 401(k) plans from prior jobs, you are required to take RMDs from those accounts.

Planning Opportunities

For many, the required minimum distribution provides support for living expenses and other needs through the year. But for others, the RMD amount is more than they need, and thus requires them to take more taxable income and pay more tax than they would prefer.

One way to avoid this predicament is to contribute to a Roth IRA if you are eligible or to a Roth 401(k) if your employer provides one. Roth accounts do not have RMDs and any withdrawals from Roth accounts are tax free, so they provide retirement growth during your working life and

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No Matter the Exchange, All Customer Trades Are Subject to SEC and FINRA Rules

Where Do Stocks Trade?

by Gerri Walsh, President, FINRA Foundation and Senior Vice President, Investor Education

When you enter an order to buy or sell a stock, what happens next? Simply put, your broker must make a decision on where to go to find someone who wants to sell their stock (if you want to buy) or buy your stock (if you want to sell). This decision is referred to as "routing" your order, and where the trade actually takes place is called the "execution venue."

The most familiar type of execution venue is a traditional exchange, such as the New York Stock Exchange or the Nasdaq Stock Market. However, other execution venues, including alternative trading systems (ATSs), single-dealer platforms (SDPs) and wholesalers, have risen in popularity in recent years. So, what's the difference between these venues? Read on to learn more.

Stock Exchanges

Stock exchanges are defined by the Securities Exchange Act of 1934 and generally include venues that bring together multiple buyers and sellers. Although set up differently from FINRA, national securities exchanges are also categorized as self-regulatory organizations (SROs), meaning they have rules of conduct that apply to their members. National securities exchanges must be registered with the U.S. Securities and Exchange Commission (SEC), and the SEC maintains a list of currently registered national securities exchanges.

Stock exchanges are also where companies go to "list" their shares, a process often referred to as "going public." That means when you see a reference to a "listed" stock, that company has met the standards established by the listing exchange.

Transactions executed on exchanges are reported and published on the consolidated tape. Exchanges are also considered "lit" markets, meaning that pre-trade quotation data — which shows whether there is interest

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then a pool of tax-free assets in retirement.

If you didn't (or couldn't) contribute to a Roth during your career, you may consider converting some or all of your retirement assets to a Roth.

Roth conversions are a complex strategy that we will discuss in detail in next month's column.

In short, you are choosing to pay taxes upfront now on the amount you convert, in order to create a pool of retirement assets that are no longer subject to RMD rules and taxes on future withdrawals.

In our December 2019 column we covered qualified charitable distributions (QCDs) from IRAs. If you regularly give to charity, or have charitable intentions in retirement, QCDs are a good way to reduce your tax bill. With a QCD you send money to a qualified charitable organization directly from your IRA. This distribution counts towards satisfying your RMD, but it does not count as taxable income.

This is particularly powerful for those who don't itemize deductions on their returns and who would not be able to claim a deduction for their contribution. The QCD allows you to give to charity, satisfy your RMD and reduce your taxable income.

Finally, if you inherit an IRA and know that you will have lower income sometime in the next 10 years, you can time the withdrawals to take them in lower income years, thus reducing your tax burden.

> **"RMD requirements apply to all retirement accounts you own."**

Navigating the Rules Is Key

Believe it or not, there are even more special situations than those noted above. The penalties for making a mistake are steep, so it's crucial to understand the rules and follow them carefully. A financial planner can help you navigate the rules, coordinate the cash flow from your retirement accounts and strategize to minimize the tax impact of your required minimum distributions.

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