December 18, 2010

IRS Rules on People over 701/2

If you are over 701/2 and have tax-deferred retirement accounts, you should withdraw some money from them. In case you did not know, compulsory minimum retirement distributions are on again. In a recent survey by Fidelity Investments, about half of people did not realize this.

In 2009, mandatory distributions were suspended due to the stock market crash where thousands of seniors lost billions of dollars in their retirement savings. Following to the crash, many seniors expressed their grievance that mandatory distributions would deplete their accounts too quickly and affect their savings for later years. As a result of this, the government granted the one-year suspension and seniors were given the option of whether to take money out of retirement accounts.

But now the year's over and in 2010, the requirement for distributions from IRAs and other tax-deferred retirement accounts are once again mandatory. In the Fidelity Investment survey, more than 20% of respondents who were required to make the distributions have not done so. Failure to make the required distributions would attract heavy penalties.

According to IRS Publication 590, the IRS can impose a 50% tax rate on you based on the amount you should have withdrawn, instead of your ordinary tax rate.

The other factor that complicates the matter is that minimum distribution rules are rather difficult to understand. The amount you should withdraw depends on a few factors, namely your age, marital status and how much your savings are. Ideally, you are to withdraw all or almost all that's in your account by the time you die. But since no one can predict how long you will live, it makes calculating the amount to withdraw difficult.

The lower and middle income retirees generally do not have a problem with the requirement as they typically withdraw more than the minimum because they need it for their living expenses. But it's their more wealthy counterparts that have a problem.

If determining the right amount to withdraw is a problem for you, you should consult a tax expert. If you want to calculate it on your own, you need to add up all the money you have in traditional retirement accounts and divide that by the 'distribution period number' on the IRS' required minimum distribution worksheet found in the IRS website, www.irs.gov.

If you and your spouse are approximately the same age, divide your account balance by the distribution period figure in the standard IRS required minimum distribution worksheet.

But there's a different worksheet for those with May-December marriages. If your spouse is more than 10 years younger than you, make sure you use the alternative worksheet.