Meeting IRA withdrawal rules

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You can't take it with you, and that definitely pleases the Internal Revenue Service. But the tax collector doesn't want you to leave a lot of your money to heirs, either. This forces senior citizens to dip into their nest eggs each year or pay additional taxes.

When you turn 70 one half you must begin taking money from your tax-deferred retirement accounts, such as a traditional individual retirement account, workplace 401(k) or self-employed retirement plans.

It's no secret why the IRS wants you to start drawing down these accounts. Your money sat in the account for years, tantalizingly out of reach of the IRS as it accrued tax-deferred earnings.

The IRS has created tables to calculate these annual withdrawals, known as required minimum distributions, or RMDs. They use longevity data and are designed to ensure that most of your retirement benefits are paid to you during your lifetime.

Although RMDs are triggered once you turn 70 one half, you get a bit of timing leeway for your first required withdrawal. You have until April 1 of the year that follows the calendar year of your 70 one half birthday, which is six calendar months after your 70th birthday.

Why withdraw?

You don't care what the rules are, you don't need the money, you don't want to pay taxes on any withdrawals and you're leaving your account untouched. Not a good idea.

Failure to withdraw triggers an excess accumulation tax. This levy is 50 percent of the required distribution that you didn't take. For example, you didn't withdraw the required $1,000 from your traditional IRA. The tax charge for your defiance is $500. For a taxpayer in the 25 percent income tax bracket, that's twice what you would have paid in taxes if you'd simply followed the RMD rule.

If you can convince the IRS that your distribution shortfall was due to "reasonable error" and that you're taking steps to rectify the situation, the agency could waive the penalty. In that case, file Form 5329 (part VIII), go ahead and pay the excess accumulation tax and attach a letter of explanation. If the IRS agrees that you shouldn't be penalized, it will refund the excess tax.

Determining your distribution

OK, you've accepted that you must start siphoning off your retirement fund. Now, it's important to find out just how much money you have to withdraw.

The IRS has created three tables based on life expectancies to figure the minimum withdrawal amount, which is a percentage of your IRA based on your age, and these can be found in IRS Publication 590.

Retirement-plan beneficiaries use the first table.

Married account owners with spouses more than 10 years younger use the second table. Because its calculations incorporate the younger age of the spouse to spread withdrawals over a longer life expectancy, these account owners don't have to take out as much.

Most account holders use Table 3, known as the uniform lifetime table. It is for singles and married savers with spouses closer to their own ages. The IRS has revised calculations in this table to reflect today's longer life spans. Under the new distribution guidelines, an individual with sufficient income from other sources can withdraw less from a retirement account, letting it grow for a while longer.

Withdrawal exceptions

The IRS does allow a few instances in which you don't have to touch your retirement money just yet.

First, if all your retirement savings are in a Roth IRA, you're exempt from this rule. Earnings in Roth accounts are tax-free, and you can leave your money in there as long as you like.

Second, if you are still working, you can wait until you actually retire before you collect from your company pension or 401(k). But if you have other, nonwork-related accounts, such as an IRA other than a Roth, you have to start taking money from them now.

Third, if you've already withdrawn the minimum required amount, either last year when you actually celebrated your 70 one half birthday or earlier this year, you don't have to worry about the April 1 deadline. And you don't have to take another RMD for the 2012 tax year. You will, however, need to take your 2013 RMD amount by Dec. 31.

Finally, if you don't need your IRA money to live on, you can transfer your RMD amount (up to $100,000) directly to an eligible charity. The nonprofit gets a nice gift, the fund transfer means you meet the IRS withdrawal requirement and the distribution doesn't count as taxable income to you. This option is available for the 2013 tax year, but unless Congress continues it, it will expire Dec. 31.

Other withdrawal rules

Even if you've been tapping retirement accounts before you became a septuagenarian, now you must keep a close eye on exactly how much you take out. All subsequent withdrawals must meet the IRS mandatory amounts.

You can always take out more than the required amount. But that won't affect distributions in future years. Say, for example, your required withdrawal this year is $1,500 but you take out $2,000. You can't carry that $500 over to count against the next required distribution. But, because you've reduced your IRA balance, your subsequent minimum distributions will likely be lowered.

Do you have multiple retirement accounts? Then you must figure the minimum withdrawal amount for each, but you don't necessarily have to raid them all. You can add the separate amounts and take the total from just one.

If you made any nondeductible contributions to your traditional IRA, make sure you have the paperwork to back that up. This is part of the reason that you need to file Form 8606, which tracks these amounts and establishes your cost basis in your account. Your nondeductible contributions are not taxed when you withdraw them. Rather, they are a return of your investment (i.e., your cost basis) in your IRA.

The IRS will let you take your required distribution in installments. Just make sure that these disbursements, be they monthly, quarterly or some other increment, total at least the yearly minimum amount you're obligated to withdraw.

Spending not required

While the IRS says you must take a specified amount of money out of your traditional IRA or other similar retirement plan, that doesn't mean you have to spend it.

The agency is interested only in collecting some of the deferred taxes on your account. That goal is accomplished as soon as you take the distribution.

If you don't need that money, or as much as you had to take out, to meet your living expenses, you can redeposit any or all of the distribution in another nonretirement savings account where it will keep earning interest for you. That's OK by the IRS, since it will get its share of these taxable earnings, too.

Bankrate's search pages can help you find the best rates on certificates of deposit or money market accounts that might be good places to stash any required IRA distributions you don't want to spend right away.