Required Minimum Distribution Rules Change After This Year

December 7, 2009 at 10:14 PM EST

Thomson Reuters Tax Analyst Considers the Pros and Cons of Retirement Decisions

NEW YORK, Dec. 7 /PRNewswire-FirstCall/ -- "The 2008 tax legislation to give senior citizens a reprieve from the requirement to take 2009 required minimum distributions (RMDs) from employer-sponsored tax-qualified retirement plans and IRAs was a relief to many," says Lesli Laffie, tax analyst for the Tax & Accounting business of Thomson Reuters. "Leaving assets in those accounts gives seniors time to recoup investment losses from the economic downturn. However, there may be sound tax reasons to either take or stop taking RMDs before 2009 ends," she advises. "And, seniors who are well-off and charitably inclined may want to consider transferring up to $100,000 of IRA funds directly to charity before 2010."

The RMD Quandary

Individuals with retirement accounts are generally required to make annual withdrawals based on the size of their accounts and their age, starting when they are 70 1/2 years-old. The *minimum* amount that a taxpayer must withdraw each year (the RMD) is based on the balance in the taxpayer's account as of Dec. 31 of the previous year, and life expectancy (obtained from IRS tables). For example, if on Dec. 31, 2008, Mr. Smith's balance in his traditional IRA account was $500,000 and his life expectancy was 10 years, his 2009 RMD from his IRA, in the absence of the RMD holiday, would be $50,000 ($500,000/10 years).

In years other than 2009, the failure to take an RMD could trigger a 50 percent penalty on the undistributed RMD. The 2009 RMD 'holiday' is available to taxpayers who own or are beneficiaries of retirement plan accounts (generally, 401(k), 403(b), or 457(b) plans), or who are traditional IRA owners or beneficiaries, or Roth IRA beneficiaries. The holiday means they can withdraw less than 100 percent of their RMDs for 2009, without incurring the penalty. The suspension without penalty applies only to RMDs otherwise required for 2009, not to RMDs for 2008 that had to be taken by April 1, 2009. Taxpayers who turned 70 1/2 in 2009 still must take an RMD by Dec. 31, 2010.

"There are a number of issues to bear in mind when deciding whether or not to withdraw in 2009," says Laffie. "For those who have inherited Roth IRAs, withdrawals are tax free, so the only decision for those beneficiaries is whether to leave or withdraw account assets."

Consider taking RMDs before 2009 ends if:

-- Your tax rate may be lower in 2009 than in 2010. The downward shift in the economy may mean taxpayers will have less investment income (interest, dividends, and capital gains) for 2009 than in 2010. Rates are always subject to change, "but if a taxpayer believes he will be in a higher tax bracket in 2010 (due to higher income and/or fewer deductions), he may want to take RMDs in 2009 to incur tax at the lower rate," advises Laffie. In addition, a 2009 RMD would lessen the amount of future RMDs. "If a taxpayer anticipates that tax rates will go up in the future, acceleration of RMDs into 2009 may be an appropriate strategy."

-- You have offsetting deductions. Taxpayers with high 2009 deductions relative to income, such as medical expenses, may be able to offset an RMD, but will lose the part of the medical deduction that equals 7.5 percent of their adjusted gross income (AGI). A taxpayer with a charitable contribution deduction carryover that will expire soon, or with a net operating loss, may also be able to offset the increase in income from an RMD.

-- You receive social security. A taxpayer whose Modified AGI (MAGI) is below the level requiring taxability of social security payments should consider taking an RMD to the extent those payments will continue to escape taxation; that is, MAGI (including the RMD) is below $25,000 for single or head-of-household (HOH) filers or below $32,000 for joint filers. In this case, the RMD is taxable income, but the social security payments will not be taxable.

-- You decide to roll over the distribution into a Roth IRA. Because RMDs are not required for 2009, a 2009 withdrawal is not considered to be an RMD. Therefore, it can be rolled over into a Roth IRA (as long as MAGI does not exceed $100,000 or you are not married filing separately). The

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rollover is taxable income to the extent it is not a return of basis.
"In 2010, more lenient rules take effect in rolling over a traditional
IRA to a Roth IRA, but they won't apply to RMDs," notes Laffie.
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Consider taking the RMD holiday (i.e., suspending RMDs) for 2009 if:

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--  More of your social security payments will become taxable. Taxpayers
    receiving social security, but whose payments have not yet triggered 85
    percent taxability (joint filers with MAGI under $44,000, or under
    $34,000 for singles and HOHs), should consider forgoing RMDs. Otherwise,
    they will find their AGI increasing by not only the RMD amount, but also
    an increased part of their social security payments.
--  Your income is high. If taking an RMD would subject you to a phaseout of
    itemized deductions and/or personal exemptions, it is probably
    beneficial to skip the RMD.
--  You have other sources of income to pay bills, and therefore do not need
    the RMD. If you will not see a benefit beyond the income from the
    distribution itself, taking an RMD will only accelerate into 2009 tax.
    You can defer this.
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But, a plan participant or IRA owner who inadvertently took an *unwanted* RMD for 2009, can rollover the RMD until the later of (1) 60 days following receipt of the distribution, or (2) Nov. 30, 2009. For IRAs, only one rollover is permitted per year per IRA. The taxpayer need not prove the distribution was taken in error, so it's an opportunity to save taxes on the distribution if the funds aren't needed.

"Skipping or taking the RMD holiday, or taking only partial RMDs, is an individual decision requiring analysis of various factors," advises Laffie. "Before 2009 ends, taxpayers should take a look at their overall tax picture and make the decision that's optimal for them."

Donating IRA Funds to Charity

Until the end of 2009, those age 70 1/2 and older can contribute up to $100,000 from their IRAs directly to one or more charities. This transfer is not included as income on the federal tax return. But you do not get a charitable deduction, and the withdrawal does not count as an RMD because RMDs are not required for 2009.

So why consider such a donation now? "For those who are very charitably inclined, the technique may hold appeal, in part because these donors won't reach the ceiling on charitable deductions," observes Laffie. "Also, by using IRA money to make the donation, a taxpayer retains more of his other savings for his own use. In addition, because the amount transferred isn't included as income on the federal return, it won't trigger deduction and/or exemption phaseouts. Finally, it may be a good strategy for people who don't itemize, because they are not losing out on a charitable deduction."

"While the RMD holiday and the ability to transfer IRA funds directly to charities end when 2009 ends, it's possible one or both of these tax breaks could be extended into 2010 or beyond," says Laffie.

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