

Required Minimum Distribution vs. “Voluntary” Distribution for 2009

The recently-passed *Worker, Retiree and Employer Recovery Act (WREERA)* suspends the requirement to take required minimum distributions (RMDs) for 2009 from the majority of retirement plans; IRAs, 401(k), 403(b), Profit Sharing Plan, certain 457 plans, etc.

Nevertheless, **does this necessarily mean you should forego taking a “voluntary” distribution this year.**

There are several ways RMDs can be required:

1. An RMD is the amount that an individual must withdraw from his or her qualified retirement account on an annual basis over the course of his or her life expectancy after retirement. Generally, distributions must begin no later than April 1 of the year following the year the individual retires or attains age 70½, whichever is later.
2. Under the RMD tax regulations, a qualified account must be completely distributed by December 31st following the fifth anniversary of the account owner’s death if one of the following is true:
 - a. If an IRA owner dies before reaching age 70½ and does not name a qualified beneficiary of his/her IRA (i.e. IRA owner names his/her estate).
 - b. If the qualified plan does not allow for non-spousal IRA rollovers (the ability to rollover plan assets to an IRA becomes mandatory for all plans starting in 2010).

Due to the suspension of the RMD rules in 2009, there will be an extension to a sixth year in situations where the fifth anniversary of an account owner’s death falls in 2009. As a result, assets can be sheltered in a tax-deferred environment for one additional year.

3. Under the RMD rules, non-spousal IRA beneficiaries (e.g. children, siblings, etc.) must begin taking RMDs beginning in the year after the year of the IRA owner’s death. However, most IRA beneficiaries do not need the RMDs. Because of the one-year suspension of the RMD rules, IRA beneficiaries can now skip 2009 and resume withdrawals in 2010.

The RMD rules are intended to prevent individuals who have no current need for the funds from extending the tax subsidy for retirement savings indefinitely. RMDs are generally calculated by looking back to the last day of the previous year. For 2008, individuals must look back to December 31, 2007. At that time, market values were generally much higher than today.

WARNING: Unfortunately, this new rule does not change the need to take your 2008 distribution. This is just for 2009. In 2010, RMDs are scheduled to start again. If you turned 70½ in 2008 and planned to defer your RMD until April 2009, you are STILL required to take the RMD even though you are taking it in 2009.

Individuals who fail to take an RMD in the year required, however, are subject to an excise tax of 50 percent on amounts not distributed.

With the 2009 RMD requirement suspended, the decision to take or not take “voluntary” distribution requires further analysis. For example:

1. You may still want to take a “voluntary” distribution in 2009 for one or more of the following reasons:
 - a. This may be a low tax year due to large deductions and you may find out that taking funds from your IRA is beneficial for you this year due to your tax bracket.
 - b. This could be a great year to convert some of your lower valued assets to a Roth IRA so when the values return they are captured in a tax free vehicle. RMD are not required for 2009. If you take a “voluntary” distribution in 2009, it is NOT an RMD. Since it is a distribution, it is eligible for conversion to a Roth IRA. A RMD is not. For example: If in 2008, you were required to take a \$40,000 RMD (based on your age and value of your account) and wanted to convert to a Roth IRA, none of the \$40,000 could be converted. You would have to take \$40,000 RMD as taxable income plus take a DISTRIBUTION of \$XXX to covert. Therefore, the \$40,000 plus the \$XXX conversion distribution would be in your taxable income. In 2009, you do not have to take an RMD in addition to the \$XXX you would like to convert, so only the \$XXX would be included in your taxable income. The conversion may benefit you because the assets are depressed and can grow (we hope) in a tax free environment without any future tax liability once transferred to a Roth IRA. Plus, this may be a year where your taxable income is minimized because you have no capital gains, low interest (because interest rates are very low) and lower phase outs on your personal exemptions and itemized deductions. A Roth IRA conversion can be accomplished without selling any of the assets being converted at a loss. Instead, you can take out any asset that is in a non-Roth IRA (Simple, SEP, Traditional) “in kind” by transferring *shares* by book entry at your broker or fund company to a Roth IRA. You then pay income tax on the value of the shares at the time of transfer. For 2009, in order to do a conversion, you still need to pass the less than \$100,000 of modified adjusted gross income test.
 - c. Do you have charitable contribution deductions that are getting ready to expire? Charitable donations are deductible based on percentage limitations of a taxpayer’s adjusted gross income. When the charitable donation exceeds the limit, the taxpayer is allowed to carry the donation forward to the next taxable year and it can be carried forward for a maximum of five years. After the fifth year, the charitable donation expires and the taxpayer receives no benefit. If, by not taking a “voluntary” distribution from your qualified plan, you reduce your income

to a level where you will receive no benefit from the charitable donation this year, you will lose any tax benefit.

2. Before you take a “voluntary” distribution, you may want to consider taking advantage of one or more of the following opportunities:
 - a. This may be a great year to accelerate medical expenses. Due to medical expenses needing to exceed 7.5% of your adjusted gross income before you receive any benefit, you may want to move that medical procedure into 2009 to take advantage of the lower income level you will have due to the suspended RMD.
 - b. Take advantage of the zero capital gain rates. If you have assets that you intend to sell that will generate a capital gain, this may be the more beneficial year to do so. For a taxpayer who can keep their taxable income in the 10% or 15% tax bracket by not taking an RMD this year, the long term capital gain rate is zero percent. By selling the asset this year you may see a significant savings in your taxes.
 - c. Under the general passive activity rules, a taxpayer who has “active participation” in a rental real estate activity is generally allowed to deduct up to \$25,000 in rental losses. However, these rental losses start to phase out once the taxpayer’s modified adjusted gross income (MAGI) goes above \$100,000. For those taxpayers who have relatively large RMDs (RMD > \$100,000), the suspension of the RMD rules in 2009 will allow these people to deduct their rental real estate losses in 2009.
 - d. You may see a significant reduction in your tax liability. Not just because you did not take a distribution but because your social security benefits may not be taxable or less of them could be taxable.

If you are interested in evaluating how this new law may impact your finances, we will be glad to talk with you about it. Feel free to contact our office at 302-644-3540 to discuss your options.