A Comprehensive Look at Intricate RMD Issues

BY WILLIAM C. GROSSMAN
This latest in a series of articles adds new questions and answers on the complex required minimum distribution rules.

RMD, Followed by Total Distribution, Then in Next Year an NEC

Q: A participant in a plan took his RMD in 2012, and then rolled the remainder out of the plan. On Dec. 31, 2012, he had a zero balance. His balance remained at zero until October 2013, when a profit sharing contribution of $280 was made to his account. Does this person need to take an RMD for 2013, and if so, what do I use for a year-end balance to calculate the RMD?

A: No RMD is needed for 2013 since there was no balance on Dec. 31, 2013. An RMD would be due for the 2014 year based on the Dec. 31, 2013 balance.

RMD for a New IRA

Q: We have a client with a date of birth of March 14, 1943. He will turn 70½ in 2013. He made a traditional IRA contribution on April 4, 2013 for the 2012 tax year. In looking at calculating the RMD, there is no Dec. 31, 2012 balance. So would there be an RMD required for 2013, and does the 2012 contribution need to be taken into account somehow?

A: If this is the IRA owner’s only traditional IRA, there would be no 2013 RMD, since there was no balance on Dec. 31, 2012.

If the client has other IRAs, he or she would have a 2013 RMD based on the Fair Market Value (FMV) in those traditional IRAs on Dec. 31, 2012.

The new IRA’s balance would not be included in the RMD calculation for 2013 since there was no balance on Dec. 31, 2013. Since the 2002 final RMD regulations, the IRS does not require contributions made for the prior year to be added to the prior Dec. 31 balance.

Note that the IRA owner is no longer eligible to make a contribution to a traditional IRA for himself (other than a rollover) because he attained age 70½ in 2013 and no one may contribute to a traditional IRA for the year they attain age 70½ or thereafter.

RMDs and Withholding

Withholding on an RMD

Q: When processing an RMD from a qualified plan, I know the RMD isn’t subject to the 20% mandatory tax withholding. However, is there any requirement to withhold taxes if the participant has not signed anything to indicate that he or she selecting not to have taxes withheld?

A: The voluntary tax withholding rules apply unless the participant elects to opt out of withholding; thus, 10% federal tax withholding should be withheld from the RMD unless the individual waves out of the voluntary withholding by using a W4-P or a form with language acceptable in lieu of the W4-P.

Withholding on Distribution of RMD and an Additional Amount

Q: This plan is set up to permit in-service distributions at age 59½. A participant is requesting a $5,000 withdrawal, of which $1,600 satisfies his RMD for 2013. He is asking that no withholding be applied because he pays quarterly withholding and his accountant said he has already paid excess taxes. Our policy is that withholding must be paid on the amount that can be rolled over. The participant said he can waive the withholding but has not specified how he would do this. Please confirm whether it is legal for him to bypass the 20% withholding and, if so, what the method is. Can he make an election on a W4-P? Is the RMD considered a periodic distribution for purposes of withholding taxes?
other qualified plans, the individual could move it by direct rollover (or participant rollover if completed within 60 days of receipt of the distribution) to the new employer’s plan. The RMD for 2013 would not be able to be rolled over

AGgregating IRA RMDs, but NOT Qualified Plans

Under Notice 88-38, the IRS permits the IRA owner to calculate the RMD for each of his or her IRAs and then total all the IRA RMDs and withdraw that RMD total from any one (or more) of his or her IRAs. Section 401(a)(9) requires that each qualified plan distribute the RMD. Unlike IRAs, there is no aggregation of the minimum of each qualified plan since each qualified plan must distribute the appropriate RMD.

Changing Jobs After 70½; Rolling From Prior Plan

Q: We know that a non-5% owner who severs employment in a year after age 70½ was reached must receive an RMD first and may not roll it over. Is there a difference in the requirement to distribute an RMD if the participant terminates from one company and then promptly takes a job at an unrelated company?

A: No, there is no difference in this type of situation. The individual would still need to take an RMD from the company from which he or she severed employment after age 70½. The RBD would be due by April 1 of the year following the year the individual retired.

If the individual gets a job at an unrelated company that has a qualified plan that accepts rollovers from the RMD is not eligible for rollover, and thus is not subject to mandatory withholding. The participant can elect to opt out of voluntary federal tax withholding on the RMD by completing a W-4-P. However, the $3,400 withdrawn, in addition to the $1,600 RMD, is an “eligible rollover distribution,” and Code Section 3405(c) requires mandatory 20% withholding. There is no way the participant can waive the 20% withholding on the $3,400.

Note that if the participant arranges to directly roll the $3,400 to an IRA, he can withdraw the $3,400 and waive the IRA’s voluntary withholding because IRAs are not subject to mandatory withholding.

AFTER-TAX FUNDS AND RMDs

Q: We have a participant with both pre-87 and post-86 after-tax funds, as well as 401(k), match and profit sharing funds. For her RMD, she would like to just take out after-tax money. Can she do this, or must she take a proportional amount of all her sources (401(k), match, after-tax, etc.)? Even if she can just take out after-tax money, does that have to be proportional (contributions plus earnings) or can she just take out basis amounts that she contributed (no tax due)?

A: There is nothing precluding the RMD from being distributed first from the pre-87 after-tax contribution, provided there are sufficient funds to satisfy the RMD. To the degree the RMD is after-tax, there would be no taxation to the participant. Once the pre-87 after-tax amount is fully distributed, post-86 after-tax amounts could be distributed, but post-86 after-tax amounts are required to be distributed on a proportional basis; (i.e., a pro-rata amount of the participant’s after-tax and pre-tax sources).

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CHANGING JOBS AFTER 70½; ROLLING FROM PRIOR PLAN

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they signed an authorization for us to calculate and process the distributions for their lifetime. We had 8,000 people on automatic payout.

**SOLO-K RMDs**

Q: One of our CPA buddies has a client with a solo-K with another firm. His client is 75 years old and still working. The other firm has been telling them that in a solo-K, no RMD is required if you are still working. Ever run into this? I don’t suppose that there is something that specifically addresses a solo-K.

A: There is no such rule for a solo-K! For a 5% owner, RMDs must start by the RBD of April 1 of the year following the year in which age 70½ is reached. It doesn’t matter if the 5% owner is in a solo-K, a profit sharing plan or any qualified plan.

Code Section 401(a)(9) and the 1.401(a)(9) final regulations of April 17, 2002 require him to start RMDs by April 1 of the year following the year in which he reaches age 70½.

**DE MINIMIS RMD AMOUNTS**

Q: We have a participant with a balance of approximately $37 who has a RMD due of $1.40. Are we required to process the $1.40 RMD?

A: Yes, an RMD is required. Similar to the previous question, this is another reason why the plan may wish to consider an administrative minimum; (e.g., if the balance is less than $500, the balance is required to be distributed).

Q: We had a distribution processed this year as a direct rollover for $47.43 for a terminated participant who is age 73. We should have processed an RMD for $3.58 before the rollover but did not do so. Is this okay since the amount is so minimal?

A: The RMD of $3.58 should not have been rolled over. Since there is no RMD de minimis, at this point you should inform the former participant that $3.58 was an RMD and it should be withdrawn before Dec. 31.

**CALCULATING RMD FOR SECOND YEAR**

Q: A 5% owner turned 70½ in 2013. His first RMD is due by April 1, 2014, and then another by Dec. 31, 2014. He took the first RMD (for 2013) on March 19, 2014. I am calculating the second distribution calendar year RMD, which is due by Dec. 31, 2014. Do I reduce the Dec. 31, 2013 balance by the RMD that was taken on March 19, 2014, or just use the Dec. 31, 2013 balance?

A: Under the 1987 proposed RMD regulations that were effective until 2002, the amount distributed during the grace period (January 1 to April 1 of the year after age 70½) was added to the preceding year balance before the second distribution calendar year RMD minimum was calculated. However, the final RMD regulations of April 17, 2002 removed the requirement of adding back the grace period distribution. So calculate the second year’s RMD using the balance on the preceding Dec. 31.

**QUALIFIED CHARITABLE DONATION DISTRIBUTIONS**

Q: What is a Qualified Charitable Donation (QCD)?

A: An IRA owner age 70½ or older may make a tax-free donation of up to $100,000 from his or her IRA to a Qualified Charitable Organization (as described in Code Section 408(d)(8)(B)(i)). This provision was first made available under the Pension Protection Act of 2006 for 2006 and 2007. Since then, Congress has (on an almost every other year basis) passed a law reviving or extending this provision of law for another two years. Currently it is available until the end of 2013.

Such a charitable donation distribution may be used toward satisfying the RMD for IRAs. Eligible IRA owners may take advantage of this provision regardless of whether they itemize deductions. The funds must be transferred directly by the IRA Trustee/Custodian to the eligible charity. Donated amounts do not qualify for the charitable tax deduction.

In order for a qualified plan participant to take advantage of this, he or she would have to take an RMD for the year from the qualified plan and then roll over an amount to an IRA. Note that it is generally too late to effect a direct rollover from a qualified plan and make a QCD from an IRA for 2013 because the IRA RMD for 2013 is based on Dec. 31, 2012 IRA balance (and in this fact set, the rollover from the qualified plan occurs in 2013). However, if Congress again passes a law to extend the QCD into 2014 and 2015 or beyond, the qualified plan participant who made a rollover into an IRA in 2013 will be ready for it.

Q: Are QCD distributions only allowed from an IRA? I can only find information related to an IRA RMD.

A: Yes, QCDs are only for IRAs, not qualified plans.

William C. Grossman, ERPA, GFS, QPA, APR, is the director of education and communications at McKay Hoffman Company, Inc.