

RETIREMENT DISTRIBUTIONS & TAXES

You work hard and for years stash money into your 401(k) or IRA. You may change employers, and have several different retirement accounts scattered around, but you never think much about taking money out – you are focused on putting money in. But, eventually this money will be withdrawn, so let's review the rules:



Before 59 ½

If you are not yet 59 ½ years old and withdraw money from a 401(k) or traditional IRA, you will not only have a taxable distribution, but also be subject to a 10% early-withdrawal penalty. Since you put the money in pre-tax, a tax is imposed when you withdraw money. What about distributions from a Roth 401(k) or a Roth IRA? After all, with them you put the money in after-tax, not pre-tax. If you are not yet 59 ½ and if you haven't had the Roth 401(k) or Roth IRA open for at least 5 years, a portion of a distribution may be taxable (the amount in excess of your cost) and this taxable portion would also be subject to the 10% penalty. There are some exceptions to the 10% penalty, such as distributions used to buy your first home, pay qualified higher education expenses, large medical costs, or amounts withdrawn in an annuity-fashion over a period of years.

59 ½ - 70 ½

From 59 ½ through 70 ½, there aren't any required distributions that you must take, nor are there any penalties if you should withdraw money. So, you will pay regular income taxes, but no penalties on withdrawals from 401(k) plans or traditional IRAs. If you withdraw from a Roth 401(k) or Roth IRA, you will pay no taxes and also have no withdrawal penalties, as long as you have had the account open for at least 5 years.

70 ½

Beginning at age 70 ½ there is a "required minimum distribution" that you must withdraw from a 401(k) or IRA. How much is this required minimum distribution? It starts at slightly less than 4% of your account balance and this percentage gradually increases over the years. Table III in IRS Publication 590 will be used by most taxpayers to calculate the annual distribution. Of course, you can always withdraw more than this minimum amount – the IRS may send you a "thank you" card if you do – but you must take out at least the minimum, or you will incur a 50% penalty tax.

Roth IRAs escape the required minimum distribution rules. You can retain your money in your Roth IRA your entire life if you want to. However, a non-spouse inheriting your Roth IRA would have to withdraw the money over their lifetime. But, a Roth 401(k) is subject to the minimum distribution rules. Therefore, if you have a Roth 401(k), it would be wise to transfer it to a Roth IRA prior to age 70 ½.

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