



MT200309 HR issued 9/03

## Withdrawals from IRAs when owner is between age 59½ and 70½ and when owner turns 70½

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Describes the tax consequences that apply to withdrawals from IRAs and other qualified retirement plans when the IRA owner is between age 59½ and 70½, or over 70½.

**I**ndividual Retirement Accounts (IRAs) are tax-advantaged savings plans available to people who meet certain eligibility requirements. IRA contributions are placed in custodial accounts at financial institutions, insurance companies, mutual funds or investment brokerage firms.

IRA owners who withdraw money from their traditional IRAs should consider the tax implications. Different tax consequences apply depending upon the IRA owner's age—under 59½, between ages 59½ and 70½, or over 70½. Other regulations govern the taxation of withdrawals made by beneficiaries after an IRA owner's death

This MontGuide focuses on the rules about withdrawals from IRAs when the owner is between ages 59½ and 70½; and when the owner turns age 70½. The MontGuide incorporates regulations generally effective Jan. 1, 2003, under the Economic Growth and Tax Relief Reconciliation Act of 2001. Three other MontGuides discuss withdrawals from IRAs:

1. Withdrawals from IRAs when the owner is under age 59½ (MT200308 HR).
2. Inheriting an IRA: Planning techniques for primary beneficiaries (MT 200310 HR).
3. Inheriting an IRA: Planning techniques for successor

beneficiaries (MT200311 HR)

Although this MontGuide focuses on the taxation of withdrawals from IRAs, the required minimum distribution rules also apply in general to other IRS qualified retirement plans, such as stock bonuses, pensions and profit-sharing plans, 401(k) plans, 403(b) annuity contracts or custodial accounts, and 457(d) deferred compensation plans.

If you have an existing qualified plan or IRA contract, review your documents carefully, as the rules may be different than the ones discussed here. Congress changes retirement laws frequently, so view this publication as a general guide.

### General rules governing taxation of withdrawals from IRAs

A withdrawal of any amount during a tax year may be subject to federal and state income taxation depending on whether the account is a Roth IRA or a traditional IRA (that is, either *tax deductible or non-tax deductible*). Similarly, taxation of withdrawals from qualified plans are determined by whether the plan consists of tax deductible or non-tax deductible contributions.

#### Roth IRA

Contributions to a Roth IRA are non-tax deductible and may be withdrawn at any time without

federal or state income taxation. Distributions of earnings from a Roth IRA are not subject to state and federal income tax if the distribution of earnings is made at least five years after the Roth IRA account has been established.

*Example:* Jim opened a Roth IRA on Jan. 1, 2003. He deposited \$2,000 on that date, \$3,000 on Jan. 1, 2004 and \$3,000 on Jan. 1, 2005. On Feb. 15, 2006 he has a balance of \$8,275 (\$8,000 in previous contributions, plus earnings of \$275). On Feb. 15, 2007, Jim withdraws \$4,000 from his Roth IRA. The distribution is treated as a withdrawal of his contributions, and is not taxable.

*Example.* On Feb. 1, 2009, Jim withdraws the balance in his Roth IRA, which is more than five years after he established it. The withdrawal consists partially of previous contributions and earnings on previous contributions. Because the withdrawal of earnings occurs more than five years after the Roth IRA account was established, none of the withdrawal is subject to federal or state income taxation. However, if Jim is under age 59½, the withdrawal of earnings is subject to a 10 percent penalty for early withdrawal, unless an exception applies (see MontGuide 200308).

## Tax Deductible IRA

For state and federal income tax calculation purposes, the amount withdrawn from a traditional *tax deductible IRA* is added to the owner's income in the year withdrawn. If the withdrawal is made before the IRA owner is age 59½, a 10 percent penalty may apply, unless an exception to the penalty is available (as discussed in more detail in MontGuide 200308).

**Example:** Bruce, age 65, withdrew \$15,000 from his tax-deductible IRA. The \$15,000 is added to his other taxable income of \$29,000. Bruce pays state and federal income taxes on total income of \$44,000 (\$29,000 other taxable income + \$15,000 IRA withdrawal = \$44,000). The additional income puts Bruce in the 27 percent federal marginal tax bracket and the 10 percent Montana marginal tax bracket. Of the \$15,000 withdrawal, Bruce "lost" \$5,550 to state and federal income taxes.

## Non-tax deductible IRA

Owners of *non-tax deductible IRAs* have distributions that consist partly of:

- (1) contributions that were already taxed (which establishes the IRA owner's cost basis in the IRA),
- (2) tax deductible contributions, and
- (3) earning or gains on the total contributions.

Non-tax deductible IRA owners who make withdrawals should complete Worksheet 1-1 in IRS Publication 590 to figure how much of their IRA distributions are tax free and how much are taxable. Information from the worksheet is entered on Form 8606 that is included with an IRA owner's federal and state income tax returns.

## Withdrawals when an IRA owner is between ages 59 1/2 and 70 1/2

Between the ages of 59½ and 70½, an owner of a Roth IRA or a traditional IRA, and a qualified plan participant, can withdraw all or any portion of his/her IRA account or qualified plan as needed for any type of purpose without paying the 10

percent early withdrawal penalty.

However, withdrawals from a traditional IRA and the taxable portion of withdrawals from a non-tax deductible IRA are added to the individual's income for the year and are subject to state and federal income taxation. If the owner is receiving Social Security, the withdrawal may cause part of the individual's Social Security benefits to be taxed as well.

## Roll-overs

Distributions from one IRA that are "rolled over" within 60 days into another IRA are not subject to income taxation or the 10 percent penalty. Special rules apply to roll-overs from traditional IRAs to Roth IRAs.

If the transfer is not directly deposited from one IRA account to another, the distribution is subject to a mandatory 20 percent withholding tax. For this reason, direct "trustee to trustee" transfers are often preferred to distributions that come into the control of the IRA owner. The roll-over rules also apply to distributions from one qualified plan to another qualified plan or to an IRA.

## Penalties and required beginning date

IRA owners (other than Roth IRA owners) and IRS qualified retirement plan participants must begin receiving *required minimum distributions* (RMD) from their IRA accounts or qualified plans by April 1 following the year in which the account owner reaches the age of 70½ (the *required beginning date*). RMD are the minimum amounts that an IRA owner must withdraw from his/her IRA account annually.

Between ages 59½ and 70½ and after age 70½, an IRA owner can always withdraw more than the minimum amount. Withdrawals from a traditional IRA plan and qualified plans are subject to state and federal income taxation. While RMD rules do not apply to owners of Roth IRAs during their lifetimes, the rules do apply to beneficiaries of a Roth IRA after the death of the owner.

## 50 percent penalty

Failure to comply with the RMD

rules can result in a penalty equal to **50 percent** of the difference between the RMD and the amount actually distributed.

**Example:** Duane miscalculated the RMD from his IRA. His RMD was supposed to be \$3,000 but he withdrew only \$2,000. Duane has a penalty of \$500 ( $\$3,000 - \$2,000 = \$1,000 \times .50$  penalty = \$500).

## Date of required distribution

The first RMD must be made by April 1 of the calendar year following the year in which the IRA owner turns 70½. For each year thereafter, the RMD must be distributed by Dec. 31.

**Example:** Steve was born on June 30, 1933. He is 70½ on Dec. 30, 2003. He must receive a RMD for the year 2003 (the year in which he reaches age 70½). His first RMD (for the calendar year 2003) must be received by April 1, 2004. For 2004 and all subsequent years, he must receive his RMD relating to those years by Dec. 31 of each year. For example, Steve's RMD for 2004 must be received by Dec. 31, 2004; his RMD for 2005 must be received by Dec. 31, 2005.

**Example:** Gayle was born on July 1, 1933. She is 70½ on Jan. 1, 2004. Gayle's first RMD (for the calendar year 2004, when she reaches age 70½) must be received by April 1, 2005. Her RMD for the calendar year 2005 must be received by Dec. 31, 2005.

The RMD rules apply generally to IRS qualified retirement plan participants (i.e., profit-sharing plans, 401(k) plans, 403(b) annuity contracts) as well as IRA owners. There are variations for participants in "defined benefit plans" and "annuity contracts."

## Calculation of required minimum distributions (RMDs) during life of IRA owner after age 70 1/2

Required minimum distributions (RMD) from IRAs are based upon:

- (1) the owner's age (more specifically, whether or not the

owner has attained his/her required beginning distribution date) and (2) the beneficiary designation.

RMD are the minimum amounts that an IRA owner must withdraw from his/her IRA account annually. The IRA owner is always free to withdraw more than the RMD. Some IRA owners prefer to withdraw only the RMD because they want to defer payment of state and federal income taxes on the amounts not yet withdrawn.

**Uniform Lifetime Table**

After the IRA owner has reached age 70½, and for the balance of his/her life, the *IRS Uniform Lifetime Table* (Table 1) is used to determine the amount of the IRA owner’s RMD each year. The use of this table is mandatory for calculating RMD after Jan. 1, 2003. The *Uniform Lifetime Table* bases its distribution factors upon a joint life expectancy (recalculated each year) and using a hypothetical beneficiary 10 years younger than the IRA owner.

The *Uniform Lifetime Table* is used regardless of the actual age of the designated beneficiary, and even if an IRA owner has not designated a beneficiary. However, a different table is used if the IRA owner’s sole designated beneficiary is his/her spouse and the spouse is actually more than 10 years younger than the IRA owner (See “Spouse more than 10 years younger” section).

**Process for determining the RMD**

To calculate the RMD, determine the IRA balance as of Dec. 31 of the year immediately preceding the year of distribution. This balance is divided by the appropriate factor set forth in the *Uniform Lifetime Table* (Table 1), using the IRA owner’s age as of Dec. 31 of the year of distribution.

*Example:* Bob is age 70 on Feb. 15, 2003. To determine his RMD for 2003, the balance of his IRA account as of Dec. 31, 2002 (\$176,000) is divided by his life expectancy period. The *Uniform Lifetime Table* (Table 1) reveals his life expectancy period for age 70 is 27.4. Bob’s RMD for 2003 is \$6,423 ( $\$176,000 \div 27.4 = \$6,423$ ).

Because Bob reached age 70½ in 2003, his first RMD does not need to be distributed until April 1, 2004. However, his RMD for 2004 must be distributed on or before Dec. 31, 2004. His RMD for each subsequent year must be distributed on or before Dec. 31 of that year.

*Example:* Elizabeth is 80 years old on Oct. 16, 2004. Her designated beneficiary is her granddaughter. Regardless of the granddaughter’s actual age, the *Uniform Lifetime Table* assumes that she is 10 years younger than Elizabeth. The distribution period for a person age 80 is 18.7 (Table 1). Elizabeth’s IRA balance on Dec. 31, 2003 (the preceding year) is \$300,000. In 2004 Elizabeth must receive a RMD by Dec. 31, 2004, of \$16,043 ( $\$300,000 \div 18.7 = \$16,043$ ).

To determine Elizabeth’s RMD for 2005, she recalculates her life expectancy using the distribution period for a person age 81 (her age as of Dec. 31, 2005). Under the *Uniform Lifetime Table*, the factor used is 17.9 (Table 1). The balance of her IRA as of the end of the immediately preceding year (Dec. 31, 2004) is divided by 17.9 to determine her RMD for 2005 (which must be distributed by Dec. 31, 2005).

To determine her RMD for 2006, Elizabeth uses a distribution period for a person age 82. Her IRA balance as of Dec. 31, 2005 is divided by 17.1 (Table 1). The RMD for 2006 must be distributed on or before Dec. 31, 2006.

**Spouse more than 10 years younger**

If a spouse is the only designated beneficiary and is more than 10 years younger than the IRA owner, then during the life of an IRA owner, the *Joint Life and Last Survivor Table* (Table 2, back page) may be used to calculate RMD instead of the *Uniform Lifetime Table* (Table 1).

Using the actual joint life expectancies (Table 2) generates a smaller RMD which, in turn, will result in less income and reduce state and federal income taxes for an IRA owner with a spouse who is more than 10 years younger than him/herself.

Each year the distribution is recalculated based on the joint life expectancies of the married couple, using their respective ages as of Dec. 31 of the year of distribution. The balance in the IRA account as of Dec. 31 of the immediately preceding year is divided by the appropriate factor from Table 2.

*Example:* As of Dec. 31, 2003, Hersh is 78, and Mary, his wife, is 67 (more than 10 years younger than Hersh). To determine the RMD for 2003 from Hersh’s IRA account, the factor of 21.0 is used from the *Joint Life and Last Survivor Table* (Table 2). The balance in Hersh’s IRA as of Dec. 31, 2002 (the immediately preceding year of \$40,000) is divided by 21.0. The RMD for 2003, which must be distributed to Hersh by Dec. 31, 2003, is \$1,905 ( $\$40,000 \div 21.0 = \$1,905$ ).

In 2004 the process is identical, but the joint distribution period is based on the married couple’s respective ages as of Dec. 31, 2004. Hersh is age 79, and Mary is age 68,

**Table 1: Uniform Lifetime Table**

Age	Distribution Period	Age	Distribution Period
70	27.4	86	14.1
71	26.5	87	13.4
72	25.6	88	12.7
73	24.7	89	12.0
74	23.8	90	11.4
75	22.9	91	10.8
76	22.0	92	10.2
77	21.2	93	9.6
78	20.3	94	9.1
79	19.5	95	8.6
80	18.7	96	8.1
81	17.9	97	7.6
82	17.1	98	7.1
83	16.3	99	6.7
84	15.5	100	6.3
85	14.8	101	5.9

so 20.1 is used as the factor for the RMD calculation (Table 2). Hersh's IRA account balance as of the end of the immediately preceding year (Dec. 31, 2003) is divided by 20.1.

### Conclusion

The rules for withdrawing funds from an IRA remain complicated even under the *Economic Growth and Tax Relief Reconciliation Act of 2001*. Readers who have other types of retirement plans may find that the terms of their plans further restrict the rules discussed in this MontGuide. One option is to roll over a plan into an IRA. IRA owners and IRS qualified retirement plan participants should seek the assistance of a specialist, such as a Certified Public Accountant (CPA), Certified Financial Planner (CFP®),

or an attorney who specializes in taxes to ensure they are following rules established by the Internal Revenue Service.

### Further information from the MSU Extension

Additional MontGuides on Individual Retirement Accounts are available from the MSU Extension Service.

Types of IRAs and changes resulting from the Economic Growth and Tax Relief Reconciliation Act of 2001: MT 199807 HR *Individual Retirement Accounts*.

Features to consider when *Shopping for an IRA*: MT 200207HR.

*Withdrawals from IRAs when the owner is under age 59½*: MT 200308 HR.

*Inheriting an IRA: Planning techniques for primary beneficiaries* (MT 200310 HR).

*Inheriting an IRA: Planning techniques for successor beneficiaries* (MT200311 HR)

All MontGuides are available free from your local MSU Extension Office. Or, send \$1 for handling to: MSU Extension Publications, PO Box 172040, MSU-Bozeman, 59717. The publications can also be downloaded without charge from the Web under retirement planning at <http://www.montana.edu/extensionecon/publications/confinpub.html> or under "Family Financial Management" at [www.montana.edu/publications](http://www.montana.edu/publications)

### Further information from the Internal Revenue Service

Individual Retirement Arrangements (Publication 590) is available from the Internal Revenue Service. For delivery via US Postal Service call 1-800-TAX-FORM (1-800-829-3676). The publication can be downloaded at: <http://www.irs.gov>. Under **Search Forms and Publications**, type **590** and click GO.

### Acknowledgment

Representatives from the following have reviewed this MontGuide and recommend its reading by all Montanans: Montana Credit Union Network and Montana Society of Certified Public Accountants

### Disclaimer

*This publication is based on laws in effect as of September 2003. It is designed to provide educational information on IRAs, not to render legal, accounting or other professional advice. If legal advice or tax assistance is required, seek the services of a competent professional.*

**Table 2: Joint Life and Last Survivor Table\***

Owner's Age	Beneficiary's Age									
	65	66	67	68	69	70	71	72	73	74
70	24.3	23.7	23.2	22.7	22.2	21.8	21.3	20.9	20.6	20.2
71	23.9	23.4	22.8	22.3	21.8	21.3	20.9	20.5	20.1	19.7
72	23.7	23.1	22.5	22.0	21.4	20.9	20.5	20.0	19.6	19.3
73	23.4	22.8	22.2	21.6	21.1	20.6	20.1	19.6	19.2	18.8
74	23.1	22.5	21.9	21.3	20.8	20.2	19.7	19.3	18.8	18.4
75	22.9	22.3	21.6	21.0	20.5	19.9	19.4	18.9	18.4	18.0
76	22.7	22.0	21.4	20.8	20.2	19.6	19.1	18.6	18.1	17.6
77	22.5	21.8	21.2	20.6	19.9	19.4	18.8	18.3	17.8	17.3
78	22.4	21.7	21.0	20.3	19.7	19.1	18.5	18.0	17.5	17.0
79	22.2	21.5	20.8	20.1	19.5	18.9	18.3	17.7	17.2	16.7
80	22.1	21.3	20.6	20.0	19.3	18.7	18.1	17.5	16.9	16.4

\*Complete tables for owners ages 35 to 115 and beneficiaries' ages can be found in IRS publication 590 "Individual Retirement Arrangements." For ages under 35, see IRS Publication 939. Both can be ordered from the IRS at 1-800-829-3676. Or, download from the web at <http://www.irs.ustreas.gov>. Search on 590.



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File under: Consumer Education  
H-20 (Investments)

Issued Sept. 2003 (2000903 ST)