KARPUS INVESTMENT MANAGEMENT

COMMENTARY

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What to do if you miss a required minimum distribution

When an individual retires and starts to withdraw from their qualified savings plans, there are rules they must follow. One of these rules involves what are known as required minimum distributions (RMDs). Failure to take an RMD can result in significant financial penalties and tax consequences. Below, we will explore the consequences of missing an RMD and the steps you can take to rectify the situation.

First things first, let's briefly discuss what an RMD is.

Simply put, an RMD is the amount of money an individual must withdraw from their retirement accounts once they reach a certain age (in 2023, the RMD age increased from 72 to 73). The purpose of an RMD is to ensure that individuals are using their tax-deferred retirement accounts for their intended purpose - which is to provide them with income during their retirement years and not just accumulate funds tax-free. The RMD is calculated based on an individual's age, life expectancy, and the balance of their retirement accounts.

Next, what happens if you don't take an RMD?

The consequences of missing an RMD can be severe. Individuals who fail to take their RMD will be subject to a penalty tax of 25% of the amount they're required to withdraw. Although severe, this penalty tax was recently cut in half in December 2022 by the SECURE Act 2.0. In terms of a simple example, if an individual were required to withdraw $10,000 and failed to do so, they would be subject to a penalty tax of $2,500. This penalty would be in addition to any regular income tax due on the distribution.

Another consequence of missing an RMD is that it can disrupt an individual's retirement income plan. Retirement accounts are designed to provide income during an individual's retirement years and if an individual fails to take their RMD, they may need more income to meet their needs in retirement.

Additionally, if an individual fails to take their RMD for multiple years, they may be subject to additional penalties and taxes. If an individual passes away before taking their RMD, their heirs may be subject to taxes and penalties on the amount not withdrawn.

Even if you miss taking your RMD, there are some steps that you can take to rectify the situation. The first step is to take the missed distribution as soon as possible. Doing so will help minimize the penalty tax and any additional taxes that may be due.

Next, you should consider filing Form 5329 with the IRS to report the missed distribution and request a waiver of the penalty tax. The IRS may waive the penalty tax if you can show that the failure to take the RMD was due to reasonable error and that you have taken steps to correct the error.

Missing an RMD can have severe consequences, including penalty taxes and disruptions to your retirement income plan. Even though there are steps you can take to rectify the situation and attempt to minimize the impact, an individual should work with a financial advisor and accountant to take proactive steps to address any missed distribution.

Please note: the foregoing is not tax advice. For tax advice, please speak to your chosen tax professional with your specific circumstances.

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Sources: Forbes, The United States Internal Revenue Service.

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