Abstract: Businesses with employees headed for retirement can provide a helpful service by educating these workers on rules regarding required minimum distributions (RMDs). If violated, these rules could trigger hefty penalties. This article explains RMD requirements for IRAs and 401(k)s. A sidebar looks at other RMD issues, such as beneficiary spouses and form of distribution.

Educate employees on required minimum distribution rules

The deadline for taking 2017 required minimum distributions (RMDs) is rapidly approaching: December 31, 2017. If you own a business and offer a 401(k) plan, it's a good time to think about how you can make sure your older employees are aware of the RMD obligations, including how the rules differ for IRAs vs. 401(k) plans.

IRAs vs. 401(k)s

To avoid a huge penalty, individuals must take RMDs from their IRAs (other than Roth IRAs) on reaching age 70½. However, the first payment can be delayed until April 1 of the year following the year in which the individual turns 70½. (Beware: Different RMD rules apply to inherited IRAs.)

Distributions from 401(k)s are different; current employees don't have to take 401(k) RMDs. Although the regulations don't state how many hours employees need to work to postpone 401(k) RMDs, they must be doing legitimate work and receiving W-2 wages.

There's an important exception, however: Owner-employees (if they own at least 5% of the company) must begin taking RMDs from the 401(k) beginning at 70½, regardless of work status.

If someone has multiple IRAs, it doesn't matter which one he or she takes RMDs from so long as the total amount reflects their aggregate IRA assets. In contrast, RMDs based on 401(k) plan assets must be taken specifically from the 401(k) plan account.

Calculating RMDs

RMD amounts change each year as the retiree ages, based on the applicable IRS life expectancy table.

For example, at age 72, the "distribution period" is 25.6, meaning that the IRS life expectancy table assumes that the account holder will live about another 25½ years. Thus, someone age 72 must withdraw 1/25.6 of his or her IRA or 401(k) account. Percentage-wise, that is 3.91%.

If someone lives to age 90, the distribution period would be 11.4, resulting in an 8.77% RMD. Although the percentage amount increases over time, the IRS rules don't force retirees to zero out their accounts. Still, if an account holder lives long enough, he or she isn't likely to have a lot of funds remaining in the account at death.

Informed and happy

Remember, informed employees are happy employees — which can lead to more engaged, productive employees. We'd be happy to assist you in providing the most current, accurate information.

Sidebar: Other facts about RMDs

Here are some additional facts about required minimum distributions (RMDs) that you can share with employees:

Beneficiary spouses. Account holders who have a beneficiary spouse at least 10 years younger are subject to a different RMD life expectancy table that allows them to take out smaller amounts to preserve retirement assets for the younger spouse.

Tax penalty. The tax penalty for withdrawing less than the RMD amount is 50% of the portion that should have been withdrawn but wasn't.

Form of distribution. RMDs can be taken in cash or in stock shares whose value is the same as the RMD amount. Although taking stock shares can be administratively burdensome, doing so can allow account holders to defer incurring brokerage commissions on securities they don't want to sell. Their tax basis in the stock (for future capital gains liability calculation purposes) will reset to the value of the securities when they're distributed.