**3634.02 What steps can be taken by an individual before the IRA required beginning date in order to minimize his or her required minimum distributions?**

The required minimum distribution (RMD) rules essentially require taxpayers to begin withdrawing funds from IRAs when they reach age 70½. The minimum amounts that must be withdrawn are calculated based on the account value and the taxpayer’s life expectancy, determined using IRS actuarial data.[[1]](#footnote-1) Despite this, there are ways that individuals can minimize their RMDs in the year prior to 70 ½ if they will have no immediate need for the funds at that time.

Many individuals are able to reduce their RMDs by converting a portion of their traditional IRA funds into Roth funds. Roth IRAs have no minimum distribution requirements, so converting traditional IRA funds to Roth accounts will reduce the owner’s RMDs. Unfortunately, if the taxpayer is still working, he or she may still be in a high enough income tax bracket that the taxes generated by the rollover can be substantial (all amounts rolled over from a traditional IRA to a Roth IRA are taxed at the owner’s ordinary income tax rate).

If the individual is still working, he or she can also consider rolling the funds into a qualified plan (such as a profit-sharing or 401(k) plan) where distributions are not required until the later of the year the taxpayer turns 70 ½ *or* the year that he or she retires. In this case, it’s important that the taxpayer learn the rules of the qualified plan before making the rollover. Some plans don’t accept rollovers, and others require that distributions begin at 70 ½ regardless of the option to postpone until retirement.

Importantly, both of these rollover moves must be made before the RMD requirements kick in—otherwise the individual will have to pay both the taxes associated with the RMD (which cannot be rolled over) and those generated by the rollover itself.[[2]](#footnote-2)

A taxpayer can also reduce RMDs by purchasing a qualified longevity annuity contract (QLAC, see Q483)—which is a relatively new annuity product that is purchased within the IRA, deferring annuity payouts until the taxpaye reaches old age. The value of the QLAC is excluded from the account value when calculating the RMDs, though the taxpayer is limited to purchasing a QLAC with an annuity premium value equal to the lesser of 25 percent of the account value or $125,000.[[3]](#footnote-3)

**[3617.02] What are the issues that an individual should consider when choosing whether to convert retirement funds to a Roth IRA or to a Roth 401(k)?**

One important characteristic of a Roth IRA conversion is the taxpayer’s ability to undo the transaction through a recharacterization transaction that moves the funds back into the traditional account, eliminating the tax liability that the initial conversion created.[[4]](#footnote-4) This option is unavailable if the individual chooses to convert to a Roth 401(k).

If the taxpayer’s account performs poorly in the months after the conversion takes place, or if the taxpayer otherwise finds that he or she can’t pay the tax bill that results from a Roth conversion, the taxpayer has until October 15 of the year following the conversion to recharacterize the funds. Once a Roth 401(k) conversion takes place, however, the taxpayer is required to pay the associated taxes regardless of any events that occur post-conversion.

Further, a taxpayer who converts to a Roth IRA is able to escape the IRS’ required minimum distribution (RMD) rules so that the funds in the account are permitted to grow tax-free over a longer period of time. Taxpayers who use Roth 401(k)s are often required to comply with the RMD rules when they turn 70 ½, possibly reducing the account’s growth potential if the taxpayer doesn’t need to access the funds.[[5]](#footnote-5) A taxpayer who plans to use a Roth account as a wealth transfer vehicle may also prefer the Roth IRA because the entire account value can be passed to heirs upon his or her death.

Taxpayers who anticipate that they will need access to the funds before retirement should also consider how the application of the “five year rule” could impact the tax-free availability of these funds. To access the funds, a qualifying event must have occurred *and* the Roth must be at least five years old before a qualified distribution is permitted. However, if the taxpayer has multiple Roth IRAs, only *one* of the taxpayer’s IRAs must be five years old before a tax-free withdrawal is permitted.[[6]](#footnote-6) With a Roth 401(k), the particular account must be five years old or a penalty tax will apply.[[7]](#footnote-7)

Importantly, for high-income taxpayers, post-conversion contributions may be limited or blocked entirely because of the income limits that apply to Roth IRA contributions (but not to Roth 401(k) contributions). In 2015, the ability to make contributions to a Roth IRA begins to phase out for married taxpayers with income over $183,000 ($116,000 for single filers). Roth IRA contributions are completely blocked for married taxpayers who earn over $193,000 and single filers who earn over $131,000.[[8]](#footnote-8)

Stronger creditor protection rules also apply to Roth 401(k) accounts. While Roth IRAs are protected under state law, the rules that apply in some states offer much less in the way of creditor protection than can be found in others. Roth 401(k)s are always protected by ERISA-mandated federal creditor protection rules regardless of where the taxpayer lives.

1. Treas. Reg. §1.408-8. [↑](#footnote-ref-1)
2. Treas. Reg. §1.408-8. [↑](#footnote-ref-2)
3. IRC Sec. 401(a)(9); Treas. Reg. §1.401(a)(9)-6. [↑](#footnote-ref-3)
4. IRC Sec. 408A(d)(6). [↑](#footnote-ref-4)
5. Treas. Reg. §1.401(k)-1(f)(3). [↑](#footnote-ref-5)
6. IRC Secs. 408A(d). [↑](#footnote-ref-6)
7. Treas. Reg. §1.402A-1, A-4. [↑](#footnote-ref-7)
8. IRC Sec. 408A(c)(3); IR-2014-99 (Oct. 23, 2014). [↑](#footnote-ref-8)