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Take Money Out Of Your IRA In 2010, Or Else

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Whoops! Lots of folks who are supposed to be taking money out of their retirement accounts this year have yet to do so, putting themselves at risk of big penalties. If you don't get around to taking "required minimum distributions" by Dec. 31, the Internal Revenue Service can ding you with a 50% penalty on the amount you were supposed to take out.

"There's a real danger," says James Guarino, a CPA with Moody, Famiglietti & Andronico in Tewksbury, Mass. "For a retiree, any amount that they have to pay in penalties is truly unnecessary. For someone on a fixed income this is something that isn't part of the budget."

A recent survey by Fidelity Investments found that half of Americans didn't know that required minimum distribution rules–the rules that say that certain taxpayers have to take certain amounts of money out of their retirement accounts each year–were reinstated for 2010. More than one in five (22%) of those required to take distributions for 2010 hadn't done so as late November, the survey found.

One reason people are probably confused is because last year Congress issued an RMD holiday. But this year the rule is back, and lots of folks seem to have overlooked it at their peril.

Oversights are for real. Guarino says he asked his mother-in-law over Thanksgiving if she had taken her 2010 IRA distributions, knowing she had skipped her 2009 distributions, and she replied, "'Well, no, do I have to?,'" so he made sure she did.

Here's the deal: once you reach age 70 and a half you must take "required minimum distributions" from your own pretax IRA or 401(k) or one inherited from a spouse each year. Whatever your age, you must take annual payouts from a pre-tax IRA inherited from a parent or someone other than a spouse. In most cases, the payout amount for the calendar year is based on your life expectancy and the IRA's balance at the end of the previous year.

One area of special confusion is for folks (born between 7/1/1938 and 6/30/1939) who would have had to taken RMDs for the first time in 2009 if it weren't for the RMD holiday. Usually for your first RMD you have until April 1 of the following year to take it, but in this case, these folks have to take their first RMD by Dec. 31, 2010, not April 1, 2011.

For most folks, they need their IRA distributions to live off, so at the beginning of the year, they set up automatic monthly payouts to meet the RMD requirements. But there are reasons to wait until the end of the year to take out the **money. For one, it stays in the account longer, growing on a tax-deferred basis.**

Guarino says he has most clients wait until fourth quarter to take out retirement account money after they've double checked their estimated tax payments for the year during a year-end tax planning review. If you're short on tax payments (say you're self-employed or took a large capital gain), you can have your IRA custodian withhold more in taxes when you take the IRA payout, and the withholding is considered paid equally throughout the year. That way you can avoid or lessen underpayment penalties, Guarino says.

Charitably-minded folks have delayed making payouts this year too, he says, waiting to see if Congress will restore a popular provision that lets you give up to $100,000 of your IRA money to a charity directly. The IRA to charity rollover provision is in the tax package awaiting Pres. Barack Obama's signature.

For more on how the IRS is cracking down on IRA mistakes, including missed required payouts, click here.

For how the 2009 RMD suspension worked, click here.

For how the IRS let some taxpayers put back 2009 RMDs they took out by mistake, click here.