Frequently asked questions

Distributions and rollovers from retirement accounts

Wealth Management

Choosing what to do with your retirement savings is an important decision. Tax implications are just one of several factors you should consider when making your decisions. Your RBC Wealth Management financial advisor is committed to helping you choose strategies and solutions to help you achieve your financial objectives.

How are my distributions from an IRA or qualified retirement plan taxed?

In general, distributions from a qualified retirement plan or IRA are taxable unless the liability can be deferred by means of a rollover to an IRA or to another retirement plan.

What is a rollover?

A rollover is a tax-free qualifying distribution of cash or other assets from one retirement plan that you contribute to another retirement plan. The contribution to the second retirement plan is called a "rollover." This transaction is reported to the IRS.

What is a qualifying rollover distribution?

A qualifying rollover distribution is the combined taxable and after-tax portions of a distribution paid from a qualified plan. Qualified plans include pension plans, profit-sharing plans, 401(k) plans, Thrift Savings Plans, ESOPs and Keogh plans.

Some types of plans, such as 403(b) plans and 457(b) plans sponsored by state and local governments, are not qualified plans. Yet distributions paid from these plans are qualifying rollover distributions and, therefore, may be eligible to roll over to an IRA.

What types of distributions may not be rolled over into an IRA or other retirement plan?

The following types of distributions are not qualifying rollover distributions:

- Required minimum distributions (taken annually beginning at age 73)
- Installments made over a specified period of 10 years or more
- Any distribution that is made due to a hardship, or in the case of a governmental 457(b) plan, any distribution on account of an unforeseeable emergency
- Death distributions paid directly to non-spouse beneficiaries or qualified domestic relations order payments to a non-spouse alternate payee
- The return of excess contributions, excess deferrals and excess aggregate contributions, together with the income allocable to these corrective distributions, under 401(k) plans
- The cost of life insurance coverage
- Deemed distributions upon the default of a participant loan
- Dividends paid on employer securities as described in Internal Revenue Code §404(k)

How do I complete a rollover?

There are two methods of moving a distribution from an employer-sponsored retirement plan to your IRA or other retirement savings plan:

Direct rollover

- A distribution is rolled over directly from the plan to an IRA or a new employer's plan. Direct rollovers are often sent directly from one trustee/custodian to the successor custodian. Alternatively, a check may be issued to you, but made payable to the successor custodian. This would also qualify as a direct rollover, since you are unable to negotiate the check.

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60-day rollover

- You take personal receipt of the distribution and must complete the rollover within 60 calendar days to avoid current taxation. Under this option, if the funds are being distributed from an employer-sponsored qualified retirement plan, the employer is required to withhold 20% of the value of the total taxable distribution as federal income tax withholding.
- Please note, when you are doing a 60-day rollover between IRAs generally, if you make a rollover of any part of a distribution from a traditional IRA, you cannot, within a 12-month period, make a tax-free rollover of any later distribution from any IRA. The 12-month period begins on the date you receive the distribution, not on the date you roll it over into an IRA.

What are the advantages of a direct rollover?

A direct rollover avoids the mandatory tax withholding of 20% of the eligible rollover amount. You also eliminate the risk of missing the 60-day rollover deadline.

What if I do not elect a direct rollover?

If you do not elect a direct rollover, the employer must withhold 20% of the distribution and forward this amount to the IRS as a prepayment for any taxes owed for the year. The check you receive will be for 80% of the distribution. For example, if your account is valued at $100,000, then $20,000 would be withheld and you would receive $80,000.

Can I still roll over the distribution?

You may roll over the full value of the distribution within 60 calendar days. But you must replace the 20% that was withheld with money from other sources to avoid income taxes and possible penalties. If the withheld amount is not reimbursed and you roll over only the portion of the distribution you received (80%), the amount that was not rolled over must be included on your tax return as additional income subject to ordinary income tax. Plus, there may be a 10% penalty tax on this amount depending on your age.

Can I roll over a retirement plan distribution into an existing IRA?

You may roll over a distribution into an existing IRA or into a new IRA.

Can I roll over only part of a distribution?

You may roll over any part of a retirement plan distribution and keep the rest. The portion that is not rolled over may be subject to the 20% mandatory withholding, ordinary income tax and possible penalties in the year the distribution is paid.

When can I get a distribution from my employer-sponsored qualified retirement plan?

Termination

Generally you or your beneficiary will become entitled to receive benefit payments under a qualified plan when your employment is terminated by reason of retirement, disability, death or otherwise.

Normal retirement age

You are entitled to a distribution at normal retirement age which is specified in your employer's plan document. However, it must be the earlier of one of the following:

- The normal retirement age specified in the plan
- Whichever of the two following dates is later:
  - The date you turn age 65, or
  - The fifth anniversary of plan participation

Under some plans the early retirement age provision combines an age and a service requirement.

In-service

In-service distributions are made to participants while they are still employed. Such distributions are not permitted under pension plans (e.g., money purchase, target benefit, and defined benefit plans). Many profit sharing plans do, however, allow for in-service distributions. There are three basic in-service distribution provisions.

They are:

- **24-month rule** — You may withdraw any contribution (but no interest earned thereon) which has been in the plan for a period of 24 months.
- **60-month rule** — After participating in the plan for 60 months, you may withdraw any or all vested contributions plus earnings.
- **Hardship distributions** — The plan document will define the requirements for a hardship distribution. Normally there must be an immediate financial need to qualify. Hardship distributions are not rollover eligible.

Are there additional taxes associated with distributions from IRAs and qualified retirement plans?

Taxable distributions from qualified retirement plans, 403(b)s and traditional IRAs made prior to age 59½ are subject to an additional 10% penalty tax. This penalty is only imposed on taxable distributions. However, a number of exceptions do exist. Some apply to all plans and some are unique to IRAs or qualified plans. See table later in this document.

What happens to after-tax contributions?

Voluntary employee after-tax (non-Roth) contributions made a to 401(k) or 403(b) may be rolled to IRA styled accounts to retain their tax advantaged status. Qualified rollovers of after-tax balances are traditionally handled in the following manner: original after-tax contribution amounts are rolled to the clients Roth IRA. All earnings from the after-tax contributions would be rolled to the clients traditional IRA. Keep in mind, earnings from after-tax contributions are taxable upon distribution, unlike earnings from Roth elective deferral contributions

where the earnings are distributed tax free if considered a qualified Roth distribution.

Can my Roth 401(k) or 403(b) assets be rolled over?

Roth 401(k) and 403(b) assets can be rolled into a Roth IRA or another 401(k) or 403(b) that allows Roth deferrals.

Can I roll my distribution from my company's retirement plan into a Roth IRA?

Assets in an employer-sponsored retirement plan may be directly converted to a Roth IRA. You will be required to pay income tax on the amount you convert. However, the amount converted is exempt from the 10% penalty. All of the taxes must be paid in the year of the conversion.

To directly convert assets from an employer-sponsored retirement plan to a Roth IRA you must have a triggering event, such as termination of employment.

What if I have a loan on my qualified retirement plan account? Can I roll the loan into an IRA?

Loans are not allowed in an IRA. You must repay all loans from your qualified plan or the loan will be considered a distribution and will be subject to taxes and possible penalties. Generally, your loan may be repaid to the plan prior to your rollover, or you may deposit all or part of the outstanding loan balance to your IRA within 60 days, assuming your loan is in good standing at the time of distribution.

What if my qualified retirement plan distribution includes employer stock?

If your lump sum distribution includes employer stock, your shares of employer stock may be included as part of a direct rollover. However, if your distribution contains highly appreciated employer stock, you may want to take the stock as a distribution rather than roll it into your IRA.

	10% penalty waiver	
Type of distribution	**Qualified plan**	**IRA**
Qualified transfer or rollover to another retirement plan	Yes	Yes
Distribution due to disability (as defined under §72(m)(7))	Yes	Yes
Qualified reservist distributions	Yes	Yes
Distributions paid to a beneficiary on account of death	Yes	Yes
Unreimbursed medical expenses that are greater than 7.5% of your adjusted gross income	Yes	Yes
Involuntary distributions due to IRS levy	Yes	Yes
Substantially equal periodic payments made over your life expectancy (or the joint lives of you and a beneficiary) and continuing the longer of five years or age 59½ (with a qualified plan, you must also separate from service)	Yes	Yes
Distributions made after a separation from service during or after the year you reach age 55 (age 50 for qualified public safety employees)	Yes	No
Divorce distributions made to a spouse (or former spouse) pursuant to a qualified domestic relations order (QDRO)	Yes	No
Distributions of dividends from an employer's employee stock option plan (ESOP)	Yes	No
Health insurance premiums during period of qualified unemployment	No	Yes
Qualified post-secondary education expenses for you, your spouse, child or grandchild	No	Yes
First-time homebuyer expenses for the purchase of a primary residence, to $10,000 lifetime limit	No	Yes
Qualified birth or adoption distributions (QBOAD)	Yes	Yes
Survivors of domestic abuse (limited to $10,000, effective 2024)	Yes	Yes
Emergency withdrawal exception (limited to $1,000)	Yes	Yes
Principal place of residence in qualified disaster area (up to $22,000)	Yes	Yes
Qualified long-term care premium payments (limited to $2,500 annually)	Yes	Yes
Terminally ill	Yes	Yes

This may be important to you because there is a special tax treatment available for in-kind distributions of employer stock as part of a lump-sum distribution from your employer's qualified retirement plan. This special tax treatment is referred to as net unrealized appreciation (NUA).

What is net unrealized appreciation?

If you take your employer stock as a distribution in-kind, meaning you receive the stock and do not roll it into your IRA, you pay ordinary income taxes on your cost basis (the price originally paid for the shares) in the shares when you take the distribution. When you sell the shares, regardless of how long you have held them, you pay long-term capital gains taxes on the NUA. NUA is the difference in value between cost basis for the employer stock and the value of that stock when it is being distributed to you as part of a lump-sum distribution.

How could this be an advantage?

Although you pay income taxes now on the stock's cost basis, you defer taxation on the NUA until you sell the shares. At that time, you pay long-term capital gains taxes, which are currently lower than ordinary income taxes. Here is an example of how this might work:

Lynn left ABC Company and received a lump-sum distribution consisting of $600,000 of ABC Company stock and $200,000 in cash. The plan's cost basis in the shares distributed was $100,000.

Lynn takes the stock as an in-kind distribution and deposits it into her brokerage account. She rolls the $200,000 in cash into her IRA. In the year of the distribution she must pay income taxes and any applicable early distribution penalty on $100,000 of ordinary income (her cost basis on the stock).

Five years later, Lynn decides to sell all of the stock for $1,000,000. At that time she will pay long-term capital gains tax on the following:

- The NUA of $500,000 ($600,000 market value less $100,000 cost basis)
- The increase in value since the date of the distribution (long-term capital gain of $400,000)

What qualifies as a lump sum distribution for NUA purposes?

The entire balance from all qualified and non-qualified deferred compensation plans you have with the employer must be distributed to you within one tax year, and the reason for the distribution must be separation from service, attainment of age 59½, or due to your disability or death.

Are there additional benefits of taking a lump sum distribution of employer stock?

There may be several other practical reasons to take a lump sum distribution of employer stock.

If you die before selling the stock, your heirs under current law will get a "step-up" in basis that eliminates the capital gains on any appreciation between the day of the original distribution from your qualified plan and the day of your death ($400,000 in the preceding example). They will still have to pay long-term capital gains tax on the original NUA amount ($500,000).

Since the employer stock will not be rolled into your IRA, the value will not be subject to RMDs when you turn 73. You can control when to pay income taxes on the NUA portion.

If you have charitable interests, you can avoid income taxes on the NUA by gifting shares directly to a charity or to a charitable remainder trust. This may also provide you with a tax deduction and lower the value of your estate.

Is there a mandatory 20% income tax withheld from my qualified plan distribution of employer stock?

Employer stock distributed from your qualified retirement plan is not subject to the mandatory 20% income tax withholding. This exception does not apply to other assets distributed from the plan.

Does the 10% early distribution penalty apply in the distribution of employer stock?

Unless you are over age 59½, or are age 55 or older and separating from service with the company, generally a 10% penalty tax will be applied to the taxable amount of the distribution.

What are substantially equal periodic payments under IRC Section 72(t)?

Substantially equal periodic payments allow you to receive distributions as a series of payments based on your life expectancy (or you and your beneficiary's combined life expectancy). This avoids the 10% penalty on premature distributions.

To qualify, these distributions must be made at least annually and continue for the longer of five years or until you reach age 59½. Plus, the amounts distributed must be calculated according to one of three IRS-approved methods:

Life expectancy

At the end of the previous year, your IRA balance is annually divided by a life expectancy factor, using either your single life expectancy, your joint life expectancy with your beneficiary or the Uniform Lifetime table. Generally, this is the same method used to calculate your required minimum distribution and will generally result in the smallest distribution possible.

Amortization

Your IRA balance is divided over your life expectancy, with the balance projected to grow at a rate that is

not greater than 5% or 120% of the federal mid-term rate for either of the two months immediately preceding the month in which distributions begin. The amortization method will produce a larger payment than the life expectancy method.

Annuitization

Your IRA balance is divided by an annuity factor that represents the present value of an annuity of $1 per year beginning in the year of the first distribution and continuing for your expected lifetime.

Since the three methods of calculating substantially equal periodic payments generally produce different results, there is some flexibility in selecting a payment amount. Once payments begin, though, the procedure is rigid and you must comply with the exact payment schedule. If the amount of the periodic payments is modified (other than by reason of death or disability) before the later of the end of the five-year period or before you reach age 59½, the 10% penalty tax is imposed on all payments previously received.

However, if you begin distributions using either the amortization method or the annuitization method, you may make a one-time switch to the life expectancy method, which reduces the required amount to be distributed. Once the switch is made to the life expectancy method, it must be used in all subsequent years. Any other change would be considered a modification and may result in penalties.

SECURE 2.0 Act changes the rules in 2024

On December 29, 2022, as part of the Consolidated Appropriations Act of 2022 (P.L. 117-328), President Biden signed the SECURE 2.0 Act of 2022 into law. Section 323 of the SECURE 2.0 Act (effective in 2024) creates an exception to the current IRS rules that prevent an individual from making partial rollovers or transfers of accounts from which 72(t) distributions are made.

Prior to this rule change, partial rollovers or transfers were considered a "modification," which triggers retroactive 10% penalties on all pre-59½ distributions taken pursuant to the 72(t) substantially equal periodic payment plan.

Clients will be allowed to make such transfers and rollovers (effective 2024) provided that the total distributions from the two accounts after the partial transfer are equal to the amount that would have otherwise been required to have been distributed.

What are required minimum distributions (RMDs)?

You cannot keep funds in a retirement plan indefinitely; eventually they must be distributed and taxed as ordinary income. You must receive at least a minimum amount for each year after your required beginning date.

When must I start taking RMDs?

Your required beginning date (RBD) is a key date in determining when your first RMD distribution is required and in determining beneficiary distribution options upon your death. The definition of required beginning date varies depending upon the type of plan.

IRAs (other than Roth IRAs)

Your RBD is April 1 of the calendar year following the calendar year in which you reach age 73.

Qualified plans

Non-5% owners — Your RBD is the April 1 of the calendar year following the calendar year in which you reach age 73 or the calendar year in which you retire from employment with the employer maintaining the plan.

5% owners — Your RBD is April 1 of the calendar year following the calendar year in which you reach age 73. A 5% owner is an individual who owns more than 5% of the business sponsoring the plan, with respect to the plan year ending in the calendar year in which they reached age 73.

How are RMDs calculated?

Your RMD is calculated each year by dividing your IRA's value on December 31 preceding the year of distribution by your applicable life expectancy factor found in IRS Publication 590.

To determine your factor, you will use the Uniform Lifetime table—except if your spouse is the sole, primary beneficiary of your IRA and your spouse is more than 10 years younger than you. In this case, the more favorable joint life expectancy table may be used.

In the year that you turn age 73, you have the option to delay your first RMD until no later than April 1 of the following year. However, if you postpone your first RMD, you will need to receive two RMDs the second year: one for your first RMD by April 1, as well as your current year RMD by December 31.

Example:

An IRA owner's date of birth is July 6, 1950. In 2023 the IRA owner will reach age 73 and must begin to take an RMD. The IRA owner may elect to defer this first required distribution until no later than April 1, 2024. The value of the IRA on December 31, 2022 is $150,000.

If the IRA owner takes the initial required distribution before December 31, 2023, the RMD is:

$$\frac{\$150{,}000}{26.5 \text{ years}^*} = \$5{,}660.37$$

*Life expectancy factor from Uniform Lifetime Table (IRS Table III)

If the IRA owner defers the initial required distribution until no later than April 1, 2024, the RMD for 2023 is still $5,660.37.

A second RMD for 2024 must be taken before December 31, 2024. By December 31, 2023, the IRA value has grown to $165,000. The RMD for 2024:

$$\frac{\$165{,}000}{25.5 \text{ years}} = \$6{,}470.58$$

What happens if I don't take my RMD?

Section 302 of the SECURE 2.0 Act modified the rules related to penalties for missed RMDs. Previously, any missed RMD was subject to a 50% excise penalty. Section 302 modifies these rules by reducing the penalty for missed RMDs to 25% and further reduces to 10% if the missed RMD is corrected between January 1 of the year following the year of the missed RMD and upon the earliest of the following dates:

- when the Notice of Deficiency is mailed to the client,
- when the tax is assessed by the IRS, or
- the last day of the second tax year after the tax is imposed.

Section 313 of the SECURE 2.0 Act amends the rules that provided for an unlimited look back for IRS penalties on missed RMDs. Section 313 creates a statute of limitations for missed RMDs that does not exceed three years from the date of the 1040 filed that should have included the RMD amount missed. For those who do not file 1040s that statute of limitations begins upon their tax filing deadline.

Are Roth IRAs subject to RMDs?

There is no required beginning date for Roth IRAs because a Roth IRA owner isn't required to take RMDs during his or her lifetime. A Roth IRA is not subject to a required distribution period until a non-spouse beneficiary inherits the assets. When a non-spouse beneficiary inherits Roth IRA assets, they are subject to the SECURE Act's 10-year rule, where annual distributions are not required. The SECURE Act's 10-year rule stipulates that the inherited or decedent beneficiary IRA account must be fully withdrawn within 10 years and by no later than December 31 of the tenth year following the year in which the original IRA owner died.

In the event the named Roth IRA beneficiary qualifies as an EDB, they will not be subject to the SECURE Act's 10-year rule, but would be subject to pre-SECURE Act beneficiary distribution rules where annual RMDs would be required based on the beneficiary's single declining life expectancy (IRS Table I).

What happens after death of the IRA account owner?

IRA and qualified retirement plan benefits bypass probate and may be paid directly to your beneficiaries. Upon inheriting an IRA, a beneficiary may be subject to RMDs. The distribution options available to non-spouse beneficiaries depend on the death date of the IRA owner.

- If the owner passed away prior to January 1, 2020 (pre-SECURE ACT), the beneficiary may have the option to stretch the IRA. This allows the beneficiary to transfer the remaining assets to their own decedent beneficiary IRA and to take required minimum distributions based on their remaining single-declining life expectancy.
- If the owner passed away on or after January 1, 2020 (post-SECURE ACT) and a non-spouse designated beneficiary was named, the beneficiary would generally be subject to the SECURE Act's 10-year rule, which in most cases will additionally require annual RMDs during that same 10-year period, provided the original IRA owner died post-RBD. See the beneficiary distribution chart on page 7 for additional information.

Spouse beneficiary

A spouse inheriting IRA assets may:

- Transfer the IRA into their own IRA
- Leave the assets in a "decedent" IRA and delay RMDs until the deceased IRA owner would have been age 73. At that time, the RMDs would be based on the spouse's single life expectancy.

SECURE 2.0 Act impacts to spouse beneficiaries

Section 327 (effective in 2024) provides for additional RMD calculation methods for surviving spouses previously only available upon timely transfers between an inherited IRA and a Traditional IRA. In the event where a decedent is younger than the surviving spouse beneficiary, it may be beneficial for the surviving spouse to assume assets into an inherited IRA where there is no RMD requirement until the year the decedent would have reached age 73. This strategy, known as "spousal delay", can help delay RMDs for surviving spouses where if they would have assumed the assets as their own in a Traditional IRA, they would begin RMDs on those inherited assets in the year following death.

For clients who are employing this "spousal delay" strategy it is important that before January 1st of the year in which the decedent would have reached 73, that you transfer the inherited IRA proceeds to a Traditional IRA in the sole name of the surviving spouse. The reason why you transfer the inherited assets in a timely manner is to ensure that when RMDs are required, they are based on the Uniform Lifetime Table (Table III). If you do not timely transfer the inherited IRA to a Traditional IRA, the first year RMD will be based on the more accelerated Single Life Table (Table I). Section 327 (effective 2024) removes the onerous timing component of transferring assets and allows for the surviving spouse's inherited IRA RMD to be based on the Uniform Lifetime Table (Table III) and not the accelerated Single Life Table (Table I).

Section 327 of the Act continues this same treatment (if the surviving spouse assumes as an inherited IRA, it is treated as assuming in a Traditional IRA) so that in the event of death of a surviving spouse who assumed assets into an inherited IRA that the beneficiaries are treated as original beneficiaries, not successor or subsequent beneficiaries therefore affording them SECURE Act distribution rules.

Beneficiary distribution options[1]		
	Beneficiary	**Distribution options**
Death before required beginning date	Spouse[1]	1. Transfer or rollover to own IRA • Lump sum distribution • RMDs over their life expectancy beginning at 73 2. Distribute assets over their life expectancy in inherited IRA structure • Distributions are required to begin by December 31 of the year following the year the deceased account owner would reach age 73. • Distributions are based on the life expectancy of the surviving spouse utilizing the Uniform Life Table (IRA Table III) • No 10% penalty for distributions from inherited IRA structure
	Non-spouse—designated beneficiary	All assets must be distributed by December 31 of the tenth year following the year of the original account owner's death unless the non-spouse beneficiary is an eligible designated beneficiary. If so, then the eligible designated beneficiary may distribute RMDs over the longer of their own life expectancy and the original account owner's life expectancy or alternatively can opt-in to the 10-year rule.
	Non-spouse—no designated beneficiary	The full balance of the account must be distributed by December 31 of the fifth year following the year of the original account owner's death.
Death after required beginning date[2]	Spouse[1]	1. Transfer or rollover to own IRA • Lump sum distribution • RMDs over their life expectancy beginning at 73 2. Distribute assets over their life expectancy in inherited IRA structure • Distributions are based on the surviving spouse's life expectancy utilizing the Uniform Lifetime table (IRS Table III) or the greater of: the life expectancy calculation based on the IRS Single Life Table (Table 1) of the surviving spouse or the life expectancy calculation based on the IRS Single Life Table (Table 1) of the deceased IRA owner • No 10% penalty for distributions from inherited IRA structure
	Non-spouse—designated beneficiary	All assets must be distributed by December 31 of the tenth year following the year of the original account owner's death while additionally satisfying annual RMDs generally based on the beneficiary's life expectancy calculation based on the IRS Single Life Table (Table 1). If the non-spouse designated beneficiary is an eligible designated beneficiary, the eligible designated beneficiary is subject to annual RMDs based on the longer of their own life expectancy or the original account owner's life expectancy.
	Non-spouse—no designated beneficiary (Charity, estate, or non-look-through trust)	All assets must be distributed based on the remaining life expectancy calculation based on the IRS Single Life Table (Table 1) of the deceased IRA owner commencing in their year of death.

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1. See Section 327 of SECURE 2.0 Act in body of fact sheet.

2. If an account owner dies after their RBD but prior to satisfying their current year RMD, their beneficiaries must satisfy the current year RMD.

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