



# Early Withdrawals and Required Minimum Distributions in Retirement Accounts: Issues for Congress

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## Summary

In response to the economic downturn, Congress considered providing relief to Americans by suspending two tax penalties on defined contribution retirement plans and Individual Retirement Accounts (IRAs). First, Congress considered allowing individuals to make withdrawals from their retirement accounts without paying a 10% penalty for withdrawals from retirement accounts by individuals under age 59½. Second, Congress considered suspending a requirement that most individuals aged 70½ and older withdraw a certain percentage of their retirement account balance each year (known as a Required Minimum Distribution (RMD)). In December 2008, the House and Senate passed H.R. 7327, which suspends the RMD requirement for calendar year 2009. On December 23, 2008, President George W. Bush signed this bill into law (P.L. 110-458).

The reasons for these proposals are that (1) the increased economic insecurity among American households means that households might consider using retirement account funds for current emergency expenses; and (2) since many individuals have at least a portion of their retirement accounts invested in the stock market, the decline in the stock market means that many retirement account balances have seen significant declines. Because the required minimum distribution taken in any year is a percentage of the account balance at the end of the previous year, many RMDs taken in 2008 were a larger percentage of the account balance on the date of the withdrawal than on December 31, 2007.

This report discusses the reasons offered in support of suspending these provisions, as well as the drawbacks. This report also presents data that estimates the number of households that these proposals would impact. Borrowing from retirement plans as an alternative to withdrawals is also discussed. Finally, the report discusses the kinds of proposals offered to either suspend or eliminate the early withdrawal penalty or the required minimum distribution provision.

This report will be updated as legislative activity warrants.

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## Introduction

Congress has been considering providing relief to Americans who have become increasingly worried about their financial security. Among the options, some have proposed reducing or eliminating the penalties on certain transactions in tax-advantaged retirement accounts. The accounts include Individual Retirement Accounts (IRAs) and qualified defined contribution (DC) plans such as 401(k) plans, 403(b) plans, and 457(b) plans.

Two proposals have been suggested: (1) suspending the penalty tax for withdrawals from IRAs and DC plans that applies to individuals under the age of 59½; and (2) suspending the penalty tax for not taking Required Minimum Distributions (RMDs) from these plans, which would primarily affect individuals age 70½ and older. While the proposals may temporarily ease individuals' financial concerns, there are potential drawbacks to be considered.<sup>1</sup> Suspending the penalties might alter the participant's behavior away from the Congressional intent that these plans provide for financial security in retirement and not be used for either pre-retirement expenses or as tax-free asset transfers to heirs. Suspending the penalty for early withdrawals would potentially leave individuals fewer assets in retirement from which to draw income. Suspending the penalty for failure to take required distributions would provide an incentive to use retirement accounts as permanent tax shelters or for intergenerational bequests.<sup>2</sup>

One of the proposals has been enacted into law. In December 2008, the House and Senate passed H.R. 7327, which suspends the RMD requirement for calendar year 2009. On December 23, 2008, President George W. Bush signed this bill into law (P.L. 110-458).

Workers benefit from tax-advantaged accounts because they are funded with pre-tax income. The U.S. Treasury estimates that the amount of the tax deduction in FY2009 received by 401(k) plan participants is \$51 billion and by IRA holders is \$12 billion.<sup>3</sup> Because the accounts are funded with pre-tax income, the accounts then have a larger base from which to accumulate investment returns compared to non-tax advantaged accounts. An additional advantage is that the funds accumulate tax-free earnings. Income tax is paid on the contributions and accrued investment earnings when they are withdrawn. In order to ensure that the accounts provide income during retirement, individuals with these accounts face penalty taxes for using the accounts for most expenses prior to the age of 59½ or for failing to take required distributions after age 70½.

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<sup>1</sup> For additional background see CRS Report RL31770, *Individual Retirement Accounts and 401(k) Plans: Early Withdrawals and Required Distributions*, by Patrick Purcell.

<sup>2</sup> Since less than 1% of estates pay the estate tax, the government would not receive much tax revenue from these plans if the RMD requirement were eliminated and households transferred the account balances their heirs. See CRS Report RS20609, *Economic Issues Surrounding the Estate and Gift Tax: A Brief Summary*, by Jane G. Gravelle.

<sup>3</sup> Table 19-1, Analytical Perspectives, Budget of the United States Government Fiscal Year 2009.

## Early Withdrawal Penalty

### Background

As the worsening economy increases Americans' economic insecurity, individuals may view their retirement accounts as a source of funds to help meet current expenses. Current law discourages the use of funds for pre-retirement expenses by imposing a penalty for some early withdrawals.

A plan that allows access to retirement account funds to current employees prior to the age of 59½ must do so through either hardship withdrawals or loans. Employers are not required to allow employees access to their DC retirement accounts before age 59½ or prior to separation from employment, but may provide for the option of making withdrawals or borrowing from the plan. The conditions for making withdrawals or taking a loan must be included in the Summary Plan Description.<sup>4</sup> **Table 1** indicates that 83.0% of households with a DC plan are able to make withdrawals and 68.2% of households with a DC plan can take loans.<sup>5</sup> **Table 1** also indicates that most households in which the head of the household is younger than 60 have access to their retirement accounts either through the ability to make withdrawals or the ability to borrow. Only 13.3% of households can neither borrow nor make withdrawals.

**Table 1. Ability to Borrow or Make Withdrawals Among Households that Have a Defined Contribution Plan**

Number of Households	Can Make Withdrawals	Can Borrow	Can Make Withdrawals and Borrow	Can Neither Borrow Nor Make Withdrawals
31,202,000	25,907,000	31,289,000	20,157,000	4,163,000
100.0%	83.0%	68.2%	64.6%	13.3%

**Source:** CRS analysis of the 2004 Survey of Consumer Finances.

**Note:** Data in the table refers to households where the head of the household is younger than 60.

### Tax Treatment of Early Withdrawals

Funds that are withdrawn from either traditional IRAs or DC plans must be included in that year's gross income. To discourage the use of retirement savings for expenses incurred prior to retirement an additional 10% tax must be paid on the amount that is included in gross income, unless the amount is rolled over into another qualified plan or IRA.<sup>6</sup> The 10% early withdrawal penalty does not apply to distributions if they are taken:

<sup>4</sup> A Summary Plan Description is a plan document required by law that describes how the plan operates. Among other items, SPDs contain information about eligibility and vesting requirements, plan benefits, and the source of contributions.

<sup>5</sup> Data in this report comes from the 2004 Survey of Consumer Finances (SCF). The SCF is a triennial survey of household wealth, conducted on behalf of the Board of Governors of the Federal Reserve. The most recent survey was conducted in 2007. The public version of the micro data from the 2007 survey is not yet available.

<sup>6</sup> See 26 U.S.C. § 72(t).

- after the individual has reached the age of 59½ ;
- if the individual is a beneficiary of a deceased IRA owner;
- if the individual is disabled;
- in substantially equal payments over the account holder's life expectancy;
- after separation from employment after the age of 55;
- for unreimbursed medical expenses in excess of 7.5% of adjusted gross income;
- for medical insurance premiums in the case of unemployment;
- for higher education expenses;
- to build, buy, or rebuild a first home up to a \$10,000 withdrawal limit;
- if the individual is a reservist called to active duty after September 11, 2001.<sup>7</sup>

## **Hardship Withdrawals**

In order for DC plans to offer hardship withdrawals, IRS regulations must be followed.<sup>8</sup> Specifically, distributions prior to the age of 59½ from a DC plan to an individual employed by the company sponsoring the plan must be on account of hardship, which is defined as an immediate and heavy financial need of the employee. The following expenses are deemed to be on account of immediate and heavy financial need:

- certain medical expenses;
- costs related to the purchase of a principal residence;
- tuition and educational expenses;
- payments to prevent eviction or foreclosure on a mortgage;
- burial / funeral expenses; or
- expenses to repair a principal residence.

Individuals must pay income tax on the amount of the hardship withdrawal distribution and, unless the distribution is for one of the exceptions listed in 26 U.S.C. § 72(t), individuals taking hardship withdrawals must also pay the 10% penalty tax. Regulations require that an individual who takes a hardship withdrawal is not permitted to make contributions to the plan for six months following the withdrawal.<sup>9</sup> As a consequence, the account would not receive the employer match. Automatic employer contributions which are not part of a matching contribution could still be made.

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<sup>7</sup> Individuals who were affected by Hurricanes Katrina, Rita, or Wilma in 2005 or the Midwestern floods in 2008 were able to take penalty-free distributions of up to \$100,000 from their retirement plans. See 26 U.S.C. 1400Q.

<sup>8</sup> IRS regulations for hardship distributions are found in 26 C.F.R. §1.401(k)-1(d)(3).

<sup>9</sup> See 26 C.F.R. § 1.401(k)-1(d)(3)(iv)(E)(2).

Unlike funds in DC plans, funds in IRAs may be withdrawn for any reason, although the amount of the withdrawal must be included in gross income and is subject to the 10% early withdrawal penalty unless one of the exceptions in 26 U.S.C. § 72(t) applies.

Relatively few households make hardship withdrawals from their retirement plans, although early distributions from retirement accounts may be increasing as a result of the worsening economy. For example, the Vanguard Center for Retirement Research notes a 22% increase in hardship withdrawals in December 2007 compared to December 2006 in plans for which Vanguard provides record keeping. However, even with this increase, only 1.5% of accounts recorded a hardship withdrawal in 2007.<sup>10</sup> It is uncertain to what extent individuals have been increasing early withdrawals from IRAs, which might be preferred to hardship withdrawals from DC plans because individuals do not have to prove hardship to make withdrawals from their IRAs.

To help households that are in financial distress, some suggest that Congress temporarily waive the early withdrawal penalty of 10% to allow easier access to retirement funds. While the proposal would help households in financial difficulty, it would run counter to Congress' stated intention that these accounts be used to encourage retirement savings. In addition, the account balances would be irrevocably harmed because (1) the individual does not have to repay the withdrawn funds to the account, and (2) the individual would lose at least six months of contributions and any employer match.

## **Borrowing as an Alternative to Hardship Withdrawals**

As indicated in **Table 1**, households often have the choice between making a hardship withdrawal or borrowing from the DC plan. Borrowing has several advantages.

- Compared to other kinds of loans, the application process is generally uncomplicated and involves little paperwork. In addition, credit checks and proof of financial hardship are not required;
- The loan usually has an interest rate of one or two percentage points above the prime lending rate. This is most likely cheaper than other sources of credit available to households;
- The interest payments are credited to the borrower's account, rather than to the lending institution. This reduces the cost of the loan to the difference between the loan interest rate and the return on the plan's assets; and
- Borrowers can continue contributing to their accounts while making the loan payment, which prevents a large break in contributions from occurring.

**Table 2** indicates that 16.5% of households that could borrow from their retirement plan in 2004 had an outstanding loan. Among households with incomes of \$25,000 or less, 5.2% had an outstanding loan. Among households with incomes from \$25,001 to \$50,000, 15.3% had a loan. Households that make less than \$50,000 are less likely to have a loan outstanding than households that make more than \$50,000.

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<sup>10</sup> Available at <https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article?File=HardshipWithdrawals>. Data for 2008 are not yet available.

**Table 2. Households that Had a Plan Loan in 2004**

Income	Number of Households that Can Borrow from Their DC Plan (thousands)	Number of Households that Have an Outstanding Loan (thousands)	Percentage of Households that Can Borrow that Have an Outstanding Loan
Income less than or equal to \$25,000	786	41	5.2%
Income \$25,001 - \$50,000	4,647	712	15.3%
Income \$50,001 - \$75,000	5,266	984	18.7%
Income more than \$75,000	10,591	1,781	16.8%
All Households	21,290	3,518	16.5%

**Source:** CRS analysis of the 2004 Survey of Consumer Finances.

**Note:** Data in the table refers to households where the head of the household is younger than 60. Percentages indicate percentage within each income group (i.e. 5.2% of households that have an income under \$25,000 and that can borrow have an outstanding loan).

## Policy Issues

Suspending the penalty for early withdrawals from retirement plans might help people in financial need. Some temporary relief might be justified, particularly with the economy in recession. Individuals might have difficulty making ends meet and might not have ready access to funds to pay for ordinary expenses. In addition, suspending the penalty might encourage participation among households that are eligible but who do not currently participate in a DC plan or have an IRA. Some individuals, particularly those with lower incomes, might decline to participate out of concern of limited or costly access to the funds in their retirement accounts if they have emergency expenses. Plans that allow access to their funds may have higher participation and / or contribution rates than plans that do not.<sup>11</sup>

However, the drawbacks of allowing access to retirement savings prior to retirement need to be considered. First, funds that individuals take from their retirement accounts to pay for current expenditures will not be available when the individuals retire; this is a concern because most households rely on a combination of Social Security and withdrawals from their DC plans or IRAs as income sources in retirement. Second, suspending the penalty on withdrawals would not help individuals who are not permitted access to their retirement accounts. Finally, the Congress has from time to time added to the exceptions to the early withdrawal penalty. Each exception increasingly makes the plans appear to be tax-deferred *savings* accounts, rather than the tax-deferred *retirement* accounts—the original intention for the tax code changes establishing these accounts.

<sup>11</sup> See, for example, U.S. General Accounting Office report, GAO/HES-98-5, 401(k) Pension Plans: Loan Provisions Enhance Participation But May Affect Income Security for Some.



# Required Minimum Distributions

## Background

Certain account holders are required to withdraw a percentage of their accounts each year, called a *Required Minimum Distribution* (RMD).<sup>12</sup> The RMD assures that tax-deferred retirement accounts that have been established to provide income during retirement are not used as permanent tax shelters or as vehicles for transmitting wealth to heirs. The RMD for a year is based on the account balance on December 31 of the prior year and on the life expectancy of the account holder or over the joint life expectancies of the account holder and his or her designated beneficiary.<sup>13</sup> The distributions from these plans must begin no later than April 1 of the year after the owner reaches age 70½. Participants in employer-sponsored plans who are still working at age 70½ can delay distributions until April 1 of the year after they have retired. This exception does not apply to traditional IRAs. In traditional IRAs, the required beginning date for distributions is always April 1 of the year after the participant reaches age 70½. Failure to take the RMD results in a tax penalty equal to 50% of the amount that should have been distributed. In addition to individuals age 70½ and older, an individual who inherits an IRA and who is not the spouse of the deceased account holder must take the RMD based on the inheriting individual's life expectancy.<sup>14</sup>

As noted above, the RMD is based on the account balance on December 31 of the year prior to taking the distribution. Financial advisors generally suggest holding assets in a retirement account in a well-diversified portfolio composed of stocks and bonds. They also suggest that the percentage invested in bonds increase with age. In practice, most households hold a large fraction of their retirement accounts in equities. Data from the 2004 Survey of Consumer Finances indicate that households invest about 70% of their IRAs in stocks; among households in which the head is 70 or older the percentage of their IRA assets invested in stocks is 66%. **Figure 1** shows the value of the S&P 500 market index from December 31, 1998, through December 31, 2008. In four of these ten years, the S&P 500 stock market index finished the year lower than when the year began. In fact, since 1950 the S&P 500 index finished below its starting value in 16 of 59 (27.1%) years. In 2008, the S&P 500 index was 39.4% lower than its value on December 31, 2007. This precipitous stock market drop was the reason for the calls to suspend the RMD requirement. For many account holders the account balances of their retirement plans were likely to be lower at any point in 2008 compared to December 31, 2007. Thus, the percentage of the account that has to be withdrawn is likely to be higher than it would be if the RMD were based on the value of the account when the RMD is distributed.<sup>15</sup>

For households whose retirement account balances have lost value because of the decline in the stock market, suspending the tax for failure to take the RMD would allow these households to

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<sup>12</sup> See 26 U.S.C. § 401(a)(9).

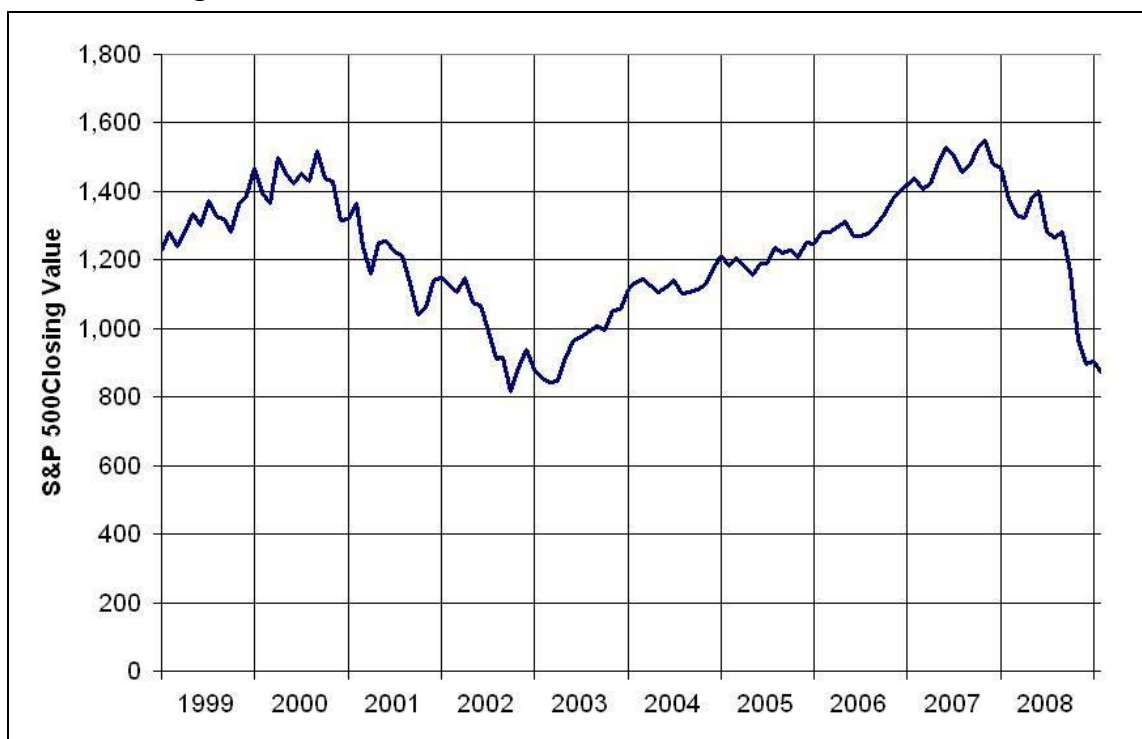
<sup>13</sup> See IRS Publication 590, *Individual Retirement Arrangements (IRAs)*, for details on determining which table in appropriate for a particular taxpayer.

<sup>14</sup> Roth IRAs have no RMD rules.

<sup>15</sup> For example, suppose an individual's account balance was \$100,000 on December 31, 2007, and declined to \$60,000 on the date that the RMD is taken. If the individual is required to withdraw 10% of the account, then the RMD is \$10,000. However, because of the decline in the account balance, the individual has to withdraw  $\$10,000/\$60,000 = 16.7\%$  of their account.

recoup the losses as the stock market rises faster than if they were required to withdraw the funds. While the funds from the RMD do not have to be spent, taxes would have to be paid. The funds could then be invested in similar financial assets in a non-tax advantaged account. However, because income taxes must be paid on the funds that are withdrawn from the tax-advantaged account, the non-tax advantaged account would have a smaller base from which to accrue investment returns. In addition, the investment returns would not accrue tax-free.

**Figure 1. S&P 500: December 31, 1997, to December 31, 2008**



Source: CRS.

Suspending the RMD penalty tax would benefit households that might prefer to not make withdrawals from their retirement accounts in order to preserve their wealth for possible future expenses, such as long-term care. In addition, wealthier households that have adequate income from sources other than retirement accounts would benefit because these funds would continue to grow in accounts where the investment earnings are tax-deferred. Lower income households that are drawing down their retirement accounts to pay ordinary expenses would likely not benefit from the removal of the tax for failure to take the RMD, as they would likely be withdrawing funds from their retirement accounts regardless of RMD penalty tax. Finally, households that had most of their retirement account invested in safe assets, Treasury bonds for example, would likely not have seen sharp declines in their account balances. Nonetheless, these households would also benefit from a suspension of the RMD requirement.

Suspending the RMD requirement can be accomplished by Congressional action to alter the tax code; it could also be accomplished through Department of Treasury regulations. Section 401(a)(9)(A) of the Internal Revenue Code requires that entire account balances be distributed

either (1) not later than the required beginning date, or (2) beginning not later than the required beginning date over the life of the individual (or the individual and a designated beneficiary) in accordance with regulation.<sup>16,17</sup> The life expectancy tables are published in the IRS regulations. The regulations note that the tables “may be changed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin.”<sup>18</sup> On October 10, 2008 House Education and Labor Committee Chairman George Miller and Health, Employment, Labor, and Pensions Subcommittee Chairman Robert Andrews called on Secretary of the Treasury Henry Paulson to suspend the tax penalty for seniors that do not take the RMD.<sup>19</sup> The letter states:

We believe that you have the legal authority to effectively eliminate this penalty by not requiring the RMD for 2008. Current law requires minimum distributions over the life of the retiree. However, the Treasury regulations interpret this as requiring annual distributions. By taking action, seniors will avoid taking unnecessary losses in their retirement accounts and avoid the current excise tax. We request that you take this action immediately to help protect and rebuild the retirement savings of older Americans.

W. Thomas Reeder, benefits tax counsel, Department of Treasury, said that Treasury is looking at ways to change the RMD rules administratively.<sup>20</sup> On December 9, 2008, William Bortz, associate benefits tax counsel for Treasury’s Office of Tax Policy, said the department is likely to release information about minimum required distributions soon.<sup>21</sup>

On December 10, 2008, the House passed H.R. 7327, the Worker, Retiree, and Employer Recovery Act of 2008, which would suspend the RMD requirement for calendar year 2009. On December 11, 2008, the Senate passed H.R. 7327. On December 23, 2008, President George W. Bush signed this bill into law (P.L. 110-458).<sup>22</sup> In a letter dated December 19, 2008, to Chairman Miller, the Department of Treasury indicated that the Treasury Department and the Internal Revenue Service would not take further action on RMD requirements for calendar year 2008 because of administrative constraints faced by individuals and plan sponsors.

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<sup>16</sup> 26 U.S.C. § 401(a)(9)(C) defines the required beginning date as the later of (1) April 1 of the year after reaching age 70½ or (2) the calendar year in which the employee retires. For IRAs, the required beginning date is April 1 of the year in which the account holder reaches age 70½.

<sup>17</sup> See 26 C.F.R. §§ 1.401(a)(9)-0 through 1.401(a)(9)-9.

<sup>18</sup> See the answer to question 4 in 26 C.F.R. § 1.401(a)(9)-9.

<sup>19</sup> The letter is available at [[http://www.house.gov/apps/list/speech/edlabor\\_dem/10102008PensionRule.html](http://www.house.gov/apps/list/speech/edlabor_dem/10102008PensionRule.html)].

<sup>20</sup> Treasury Is Weighing Options for Waiving Minimum Withdrawal Penalty During Crisis, *Pension & Benefits Daily*, Bureau of National Affairs, Inc., October 22, 2008, available at [[http://news.bna.com/pdln/PDLNWB/split\\_display.adp?fedfid=10953879&vname=pbdnotallissues&fcn=3&wsn=499910500&fn=10953879&split=0](http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=10953879&vname=pbdnotallissues&fcn=3&wsn=499910500&fn=10953879&split=0)].

<sup>21</sup> Treasury Official Talks of Solution to Ease Losses from Minimum Required Distributions, *Pension & Benefits Daily*, Bureau of National Affairs, Inc., December 10, 2008, available at, [[http://news.bna.com/pdln/PDLNWB/split\\_display.adp?fedfid=11134188&vname=pbdnotallissues&fn=11134188&jd=A0B7P5G7U1&split=0](http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=11134188&vname=pbdnotallissues&fn=11134188&jd=A0B7P5G7U1&split=0)].

<sup>22</sup> After the enactment of P.L. 110-458, the IRS provided guidance to financial institutions on reporting RMDs in IRS Notice 2009-9.

## Estimates of the RMD

**Table 3** contains data from the 2004 Survey of Consumer Finances (SCF), which indicate that in 2004 just over 5 million households had a head of household who was 70 or older with balances in a retirement account that would likely be subject to the RMD. The 5.15 million households subject to the RMD had total account balances of \$845.9 billion.<sup>23</sup> The average account balance was \$164,303 and the median account balance was \$43,368. Using the table for single life expectancy on page 89 from IRS publication 590, CRS estimates that \$70.0 billion would have been withdrawn in RMDs from these accounts. The average RMD would have been \$13,204 and the median RMD would have been \$3,236.<sup>24</sup> The large difference between the mean and median RMD estimates suggests that while some households have large RMDs, most households have more modest minimum distributions.

**Table 3. Required Minimum Distributions in 2005**

Age	Number of Households (thousands)	Total Account Balances (millions)	Average Account Balance	Median Account Balance	Total Required Minimum Distribution (millions)	Average RMD	Median RMD
70 - 74	2,014	\$454,775	\$225,847	\$76,727	\$29,467	\$14,633	\$4,884
75 - 79	1,866	\$221,689	\$118,781	\$31,136	\$18,247	\$9,777	\$2,408
80 +	1,268	\$169,399	\$133,577	\$39,698	\$20,264	\$15,979	\$4,143
Total	5,148	\$845,864	\$164,303	\$43,368	\$67,979	\$13,204	\$3,236

**Source:** CRS analysis of the Survey of Consumer Finances (SCF).

**Notes:** Dollar amounts adjusted for inflation to December 2007 using the Consumer Price Index.

**Table 4** classifies the RMD data by four household income groups where the head of the household is 70 or older: less than \$25,000; from \$25,001 to \$50,000; from \$50,001 to \$75,000; and more than \$75,000. While only 20.5% of households make more than \$75,000, these households receive 63.6% of the RMD. The 57.3% of households that earn \$50,000 or less, take 20.8% of the RMD. This income group would likely be taking the RMD for living expenses anyway. Most of the benefit of removing the RMD penalty would likely go to the higher income households. The amount of income tax that these households would pay ultimately depends on many factors.

<sup>23</sup> The dollar amounts in this paragraph are adjusted for inflation to reflect the value of the accounts at the end of 2007.

<sup>24</sup> These numbers compare closely with those found in the Survey of Income Program and Participation, which indicates that 5.5 million households were headed by persons aged 70 or older with an IRA or 401(k) Account in 2005. See CRS Report RL31770, *Individual Retirement Accounts and 401(k) Plans: Early Withdrawals and Required Distributions*, by Patrick Purcell.

**Table 4. Required Minimum Distributions (RMD) by Households Where the Head is 70 or Older**

	Income less than or equal to \$25,000	Income \$25,001- \$50,000	Income \$50,001- \$75,000	Income more than \$75,000
Number of Households (thousands)	1,014	1,934	1,146	1,053
Percentage of Households	19.7%	37.6%	22.3%	20.5%
Total Account Balances (Million)	\$31,162	\$137,308	\$143,281	\$534,113
Percentage of Total Account Balances	3.7%	16.2%	16.9%	63.1%
Average Account Balance	\$30,724	\$70,996	\$124,981	\$506,994
Median Account Balance	\$11,120	\$33,360	\$61,159	\$214,614
Total RMD in Millions	\$2,752	\$11,407	\$10,578	\$43,241
Percentage of Total RMD	4.1%	16.8%	15.6%	63.6%
Average RMD	\$2,714	\$5,898	\$9,227	\$41,045
Median RMD	\$747	\$2,926	\$4,816	\$15,027

**Source:** CRS analysis of the 2004 Survey of Consumer Finances.

**Notes:** Dollar amounts adjusted for inflation to December 2007 using the Consumer Price Index. Percents may not add up to 100% due to rounding.

## Policy Issues

Suspending the penalty for failure to take the RMD gives individuals—mostly those older than 70½—the opportunity to recover the losses in their retirement accounts more quickly than if the funds were withdrawn and placed in a non-taxed advantaged account that held similar or identical investments. However, given the amount of the typical (median) RMD amount of approximately \$3,200, the benefit to most households would likely be modest. In addition, lower income households are not likely to benefit from the suspension of the RMD penalty. Lower income households would likely be making withdrawals from their retirement accounts even if the penalty on the failure to take the RMD were to be suspended.

One option would be to allow households to make the RMD based on their account balance at the time of the withdrawal, thus ensuring households that their RMD is not “too large” relative to the account balance at the end of the previous year. However, this could prove costly for plan administrators to implement. In addition, if permanent, this option would not lead to the full distribution of the account over the expected lifetime of the account holder, as required by current law.

Another option would be to raise the age at which required distributions would begin. Assuming the requirement to fully disburse the account over the expected lifetime of the individual remains

in place, implementing this policy option would merely raise the amount of required distributions, since the account would still need to be fully dispersed. This would occur over a fewer number of years.

Some have suggested eliminating the RMD requirement altogether. This would be identical to providing tax-free conversions from traditional IRAs to Roth IRAs. There would likely be a large cost to the U.S. Treasury. In 2006, the U.S. Treasury reported \$124 billion in taxable IRA distributions from IRAs.<sup>25</sup> In addition, individuals who had previously converted from a traditional to a Roth IRA might consider eliminating the RMD requirement unfair because they had previously paid taxes on their conversions. Also, the conversion of accounts from traditional IRAs to Roth IRA is currently limited to taxpayers with a Modified Adjusted Gross Income for Roth IRA Purposes below \$100,000.<sup>26</sup>

## **Proposals to Eliminate or Suspend the 10% Early Withdrawal Penalty**

Some policy analysts have suggested various proposals to eliminate or suspend the 10% early withdrawal penalty in certain circumstances. In general, the proposals would add a paragraph to 26 U.S.C. § 72(t) to eliminate the penalty in a particular circumstance. It should be noted that with each provision added to 26 U.S.C. § 72(t) the accounts increasingly operate more like general tax-deferred *savings* accounts and less like tax-deferred *retirement* accounts.

The proposals include eliminating or suspending the 10% early withdrawal penalty for:

- public safety employees who retire before age 55;<sup>27</sup>
- workers who are unemployed;<sup>28</sup>
- individuals affected by natural disasters;<sup>29</sup>
- homeowners at risk of having their mortgage foreclosed;<sup>30</sup>
- individuals who receive a hardship distribution from a retirement plan;<sup>31</sup> and
- individuals who have qualified adoption expenses.<sup>32</sup>

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<sup>25</sup> See Statistics of Income Tax Stats, Table 1: Individual Income Tax, All Returns: Sources of Income and Adjustments. Available at [[http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html#\\_complete](http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html#_complete)].

<sup>26</sup> For more information see IRS Publication 590, *Individual Retirement Arrangements (IRAs)*.

<sup>27</sup> See, for example, H.R. 721 in the 111<sup>th</sup> Congress.

<sup>28</sup> See, for example, H.R. 656 in the 111<sup>th</sup> Congress.

<sup>29</sup> See, for example, H.R. 1424/P.L. 110-343 in the 110<sup>th</sup> Congress.

<sup>30</sup> See, for example, H.R. 5822, H.R. 5776, H.R. 4627, and S. 2201 in the 110<sup>th</sup> Congress.

<sup>31</sup> See, for example, H.R. 7278 in the 110<sup>th</sup> Congress.

<sup>32</sup> See, for example, H.R. 3785 in the 110<sup>th</sup> Congress.

## **Proposals to Eliminate, Suspend, or Delay Required Minimum Distribution (RMD) Requirements**

Policymakers have suggested various proposals to eliminate or suspend the RMD requirements. These proposals would:

- Suspend the RMD requirement for an additional year;<sup>33</sup>
- Suspend the RMD requirement for several years;<sup>34</sup>
- Eliminate the RMD requirement;<sup>35</sup> or
- Raise the required beginning date, which would raise the age at which individuals must begin taking their RMDs.<sup>36</sup>

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<sup>33</sup> See, for example, H.R. 424 in the 111<sup>th</sup> Congress or HR or H.R. 7327/P.L. 110-458 in the 110<sup>th</sup> Congress.

<sup>34</sup> See, for example, S. 157 in the 111<sup>th</sup> Congress, H.R. 7315, H.R. 7293, H.R. 7279, H.R. 7278, H.R. 7277 in the 110<sup>th</sup> Congress.

<sup>35</sup> See, for example, H.R. 396 and S. 1040 in the 110<sup>th</sup> Congress.

<sup>36</sup> See, for example, H.R. 7283 in the 110<sup>th</sup> Congress.