TaxBrief
Keeping you informed

Traditional and Roth IRA Withdrawals for Retirement

Individual retirement accounts (IRAs) are a cornerstone of retirement planning for millions of Americans. However, when and how you withdraw money from an IRA can significantly impact your taxes and retirement income. If you own a traditional IRA, a Roth IRA, or both, you must understand the withdrawal rules to avoid unexpected penalties.

Understanding traditional vs. Roth IRAs

Traditional IRAs offer potential tax-deductible contributions and tax-deferred growth before withdrawal. However, retirement distributions are generally taxable as ordinary income.

Roth IRAs are funded with after-tax dollars and grow tax-free. Qualified distributions from Roth IRAs are entirely tax-free, making them a powerful tool for retirement planning.

Traditional IRA timing and taxes

One of the most essential rules of traditional IRAs is the requirement to take minimum distributions (RMDs) by a certain age. That age has increased from 70 ½ to 73 with the Secure 2.0 Act. If you turned 73 in 2024 or later, you must start RMDs by April 1 of the following year After the first RMD withdrawal, you must take a distribution by Dec. 31 of each subsequent year. Failing to take an RMD every year will trigger a penalty equal to 25% of the required withdrawal amount.

For example, if you turned 73 in November 2024, you must take your first distribution by April 1, 2025 and you'll need to take a second RMD before December 31, 2025. Both withdrawals will be reported on your 2025 tax return.

Traditional IRA withdrawals

Withdrawals from a traditional IRA are taxed as ordinary income in the year of distribution. The taxable amount depends on whether the taxpayer made any nondeductible contributions that need to be deducted from the taxable amount of the RMD. If the IRA contains both deductible and nondeductible contributions, the IRS uses a pro-rata formula to calculate the taxable portion of each distribution. To avoid double taxation, we'll track your nondeductible contributions on Form 8606, *Nondeductible IRAs*.

Early withdrawals and penalties

Distributions taken before age 59½ are considered early withdrawals and generally incur a 10% penalty on top of regular income tax because the distribution is added to other taxable income. However, there are exceptions to this penalty for specific situations, such as:

- Total and Permanent disability
- Qualified higher education expenses
- First-time home purchase (up to $10,000 lifetime limit)
- Certain unreimbursed medical expenses exceeding 7.5% of adjusted gross income
- Health insurance premiums during unemployment
- Qualified birth or adoption expenses (up to $5,000)
- Qualified reservist distributions

Qualified vs. non-qualified distributions

You can withdraw money from your Roth IRA tax-free and penalty-free if two things are true:

1. At least five years have passed since you first contributed to your Roth IRA.
2. You meet at least one of the following conditions:
    a. You're at least 59½ years old
    b. You have a permanent disability
    c. You're buying your first home (up to $10,000 lifetime limit)
    d. The money is paid to a beneficiary after your death

If you withdraw earnings before meeting these two conditions, you might owe regular income tax and a 10% penalty on the earnings (the amount your investments grew above your original contributions). Certain special situations may allow you to avoid the 10% penalty. If you're unsure, please contact our office for guidance.

Order of withdrawals

When it's time to withdraw funds from your IRA, the IRS specifies that Roth IRA withdrawals are taken out in this order:

- Contributions (always tax and penalty-free)
- Conversion amounts (taxable portion depends on whether tax was paid at conversion; a 10% penalty may apply if withdrawn within five years of the conversion)
- Earnings (taxable and subject to penalty if not qualified)

Roth vs. traditional RMDs

Traditional IRA owners must begin taking RMDs after reaching the required age. A key advantage of Roth IRAs is that owners are not required to take RMDs during their lifetime, allowing funds to grow tax-free for beneficiaries. Roth IRAs must be fully distributed within 10 years after the original owner's death.

Withholding and estimated tax payments

When you take an IRA distribution, it is generally subject to federal income tax withholding at a default rate of 10%, unless you elect otherwise on Form W-4P. If the withholding or estimated tax payments you make during the year are insufficient, you may owe additional tax and interest when it's time to file.

Strategies for managing IRA withdrawals

Here's a few strategies we can discuss at your next appointment when you're ready to start taking distributions.

- **Delay RMDs.** If you don't need those extra funds right away, delaying your first RMD until April 1 of the year you turn 73 could lower your current year tax liability.
- **Roth conversions.** Consider converting part of your traditional IRA to a Roth IRA before you start taking RMDs, especially in lower-income years. This can reduce future RMD amounts and provide tax-free growth.
- **Coordinate with Social Security.** Review how your IRA withdrawals might increase or decrease how much of your Social Security benefits are taxed, or if your Medicare premium surcharge changes.
- **Charitable giving.** For tax year 2025, individuals age 70½ and older can make qualified charitable distributions (QCDs) of up to $108,000 directly from an IRA to a qualified charity, satisfying RMD requirements and excluding the amount from taxable income.

Plan ahead for tax-efficient withdrawals

The rules for withdrawing from IRAs are complex, and mistakes can trigger unnecessary taxes and penalties. If you're considering an early withdrawal, schedule a meeting with me to discuss the implications before withdrawing.