How Are Required Minimum Distributions Taxed?

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If the thought of paying hefty taxes on your Required Minimum Distribution (RMD) makes you nervous — you're not alone. As you approach age 73, RMDs may become an administrative and tax concern. While some retirees may already have a need for the cash, others may find their required distribution to be an inconvenient burden. However, with a solid understanding of how RMDs can impact your taxes, you can navigate tax season with ease.

Why Do RMDs Exist?

Tax-deferred accounts are popular among savers because they offer tax benefits and tax diversification. Contributions made to these accounts are tax-deferred, meaning you won't pay taxes on the contributions, or the investment income and gains earned within the account until you withdraw the money. This can incentivize individuals to keep their money in the account for as long as possible, which can make it challenging for the IRS to calculate how much tax revenue to expect. As Uncle Sam always wants his share, the government created RMDs as a way to ensure they have a steady stream of tax revenue coming from these accounts.

How Will My RMD Be Taxed?

RMDs and all other withdrawals from tax-deferred accounts will be added to your ordinary income for that year and will be taxed accordingly. Your exact ordinary income rate depends on your annual income and filing status.

Note: You don't pay FICA taxes (Medicare and Social Security) on retirement account withdrawals.

2023 FEDERAL ORDINARY INCOME TAX RATES

Tax Rate	Single	Married, Filing Jointly	Head of Household
10%	$0 to $11,000	$0 to $22,000	$0 to $15,700
12%	$11,000 to $44,725	$22,000 to $89,450	$15,700 to $59,850
22%	$44,725 to $95,375	$89,450 to $190,750	$59,850 to $95,350
24%	$95,375 to $182,100	$190,750 to $364,200	$95,350 to $182,100
32%	$182,100 to $231,250	$364,200 to $462,500	$182,100 to $231,250
35%	$231,250 to $578,125	$462,500 to $693,750	$231,250 to $578,100
37%	$578,125 or more	$693,750 or more	$578,100 or more

To illustrate how your taxes may play out, imagine a married couple filing jointly with $150,000 of taxable income ($20,000 coming from their RMDs). To find the tax bill on their required distribution, you need to multiply the RMD by the applicable tax rate. Since their income places them in the 22% bracket, they would have a total tax bill of $4,400 on their RMD.

You can choose to pay that tax bill when filing your return or withhold taxes on the RMD. If you opt for the latter, your calculated RMD will not be the amount you actually receive. For instance, someone in the 22% tax bracket with a total RMD of $20,000 would only receive $15,600 of their distribution because $4,400 is withheld for federal taxes.

Can RMDs Affect My Ordinary Income Tax Rate?

All withdrawals from tax-deferred accounts are added to your annual ordinary income for that tax year, affecting which tax bracket you fall into. For instance, an individual hovering between the 12% and 22% tax brackets may be pushed into the higher bracket once they withdraw their RMD. It's essential to consider **all your income sources** and plan accordingly to minimize your tax burden.

Will I Owe State Taxes on My RMD?

While federal tax is often people’s first concern, as RMDs are taxed as ordinary income, you’ll also need to consider state income tax. The rules and rates for state income tax vary widely, with some simplifying their tax with a flat rate and some not imposing an income tax at all. Since the stipulations on state income tax vary greatly, you should research your state’s tax brackets and rates to have a thorough understanding of how you will be taxed.

The Bottom Line

Juggling your required distributions with other retirement income sources can be quite challenging. It's essential to keep in mind that your RMDs will be treated like any other withdrawal from a tax-deferred account and will be included in your overall taxable income, which is subject to ordinary income rates. By understanding the intricacies of RMDs, you can take the necessary steps to ensure you’re getting the most out of your retirement income.