Traditional IRAs

Deadline to Establish and Fund an IRA

An IRA can be established and funded at any time from January 1 of the current year and up to and including the date an individual's income tax return is due (generally, April 15 of the following year), not including extensions.

Can Deduction Be Taken Prior to Investing the Funds?

Yes! This, in effect, permits an individual to file his return early in the year (e.g., January) and use his or her tax refund to make the actual contribution prior to April 15. If desired, refunds of federal income taxes may be directly deposited into an IRA.

Types of Arrangements Permitted

There are currently two types of IRAs:

- **Individual retirement accounts:** These are trusts or custodial accounts with a corporate trustee or custodian.
- **Individual retirement annuities:** Special annuities issued by an insurance company.

Contribution and Deduction Limits

A taxpayer may contribute the lesser of $6,000[1] or 100% of compensation[2] for the year. If a taxpayer is married, an additional $6,000 may be contributed on behalf of a lesser earning (or nonworking) spouse, using a "spousal" IRA. Thus, the family could contribute up to $12,000[3] as long as total family compensation is at least that amount. If a taxpayer is age 50 or older, he or she may contribute an additional $1,000 ($2,000 if the spouse is also age 50 or older). Beginning in 2020, contributions may be made to any age. If certain requirements are met, the contributions may also be deducted from gross income on the federal income tax return.

[1] This amount applies to 2021. For 2020, the maximum allowable contribution was also $6,000.
[2] "Compensation" includes taxable wages, salaries, or commissions, or the net income from self-employment.
[3] This amount applies to 2021. For 2020, the maximum allowable contribution was also $12,000.

Participating In Other Retirement Plans May Reduce Deductions

Taxpayers who participate in an employer's plan may make fully-deductible IRA contributions only if their modified adjusted gross income (MAGI)[1] is below $105,000 if married filing jointly, $66,000 if single, and $0 if married filing separately. If MAGI exceeds these amounts, the $12,000 family or $6,000 individual maximum is reduced by a formula that eventually permits no deduction. No IRA deduction is allowed for married couples filing jointly with MAGI over $125,000, single individuals with a MAGI over $76,000, and married couples filing separately with an individual MAGI over $10,000[2].

For 2021, a taxpayer who is not an active participant in an employer plan, but whose spouse is, the maximum deductible IRA contribution is phased out if their combined MAGI is between $198,000 and $208,000.

Employer plans include: regular qualified plans; Keogh plans; Sec. 403(b) tax-sheltered annuity plans; simplified employee pension (SEP) plans; SIMPLE plans; and state, federal and local government plans (except Sec. 457 tax-exempt employer sponsored nonqualified deferred compensation plans).

Individuals with income in excess of the above limits may wish to consider contributing to either a traditional IRA or a Roth IRA, on a nondeductible basis. There are income limits applicable to Roth IRA accounts which may prevent a high-income taxpayer from contributing to a Roth IRA.

Distributions, Withdrawals and Taxation

- **Typical distribution plans.**
  - **Single-sum distribution:** Becomes part of taxable income for that year (less any nondeductible contributions).
  - **Life expectancy:** Each year, participant calculates payout based upon the attained-age life expectancy, using life expectancy tables issued by the federal government.

[1] Modified adjusted gross income (MAGI) is a taxpayer's adjusted gross income (AGI) with certain deductions or exclusions added back. For most taxpayers, MAGI and AGI are the same.

[2] These are 2021 limits. For 2020 the phase-out ranges were (1) MFJ - MAGI of $104,000 - $124,000; (2) Single - $65,000 - $75,000. For taxpayers using the MFS filing status, the phase-out range is $0 - $10,000, which does not change.

  - **Life annuity:** For individual retirement annuities only, participant/annuitant may elect income for life (and the life of a joint annuitant, if desired).

- **Premature distributions:** Distributions from a traditional IRA prior to age 59½ are generally subject to an additional 10% penalty (plus being subject to current income tax) unless one or more of the following exceptions apply:[1]

  - A distribution is made because of the death or disability of the account owner.
  - A withdrawal is part of a scheduled series of substantially equal periodic payments.
  - A distribution is transferred into another IRA.
  - A withdrawal is used to pay for deductible medical expenses.
  - The distribution is used to pay for certain qualified higher-education expenses.
  - Amounts are withdrawn to pay for first-time homebuyer expenses of up to $10,000.
  - In certain situations, to pay health insurance premiums for unemployed individuals.
  - Distributions by certain military reservists called to active duty after 09/11/2001.
  - A distribution is transferred to a Health Savings Account (HSA).
  - In case of an IRS levy on the account.
  - To pay expenses (up to $5,000 per parent) related to the birth or adoption of a child.
  - A distribution is a Coronavirus-related distribution.

- **Required minimum distributions (RMDs):** These distributions must begin by April 1 of the calendar year following the year in which the participant reaches age 72[2]. However, if the distribution is received in the year following attainment of age 72, two distributions are required in that specific year. Thereafter, the minimum distribution must be made by the end of each calendar year. A 50% excise tax is levied[1] on amounts that should have been distributed, but were not. The dollar amount of each year's RMD is calculated using one of two life expectancy tables:

[1] Based on federal law. State law may vary.

[2] The age 72 "trigger" date applies to distributions required to be made after December 31, 2019, to individuals who reach age 70½ after that date. Under prior law, age 70½ was the mandated age for beginning RMDs.

- **Over the life expectancy of the participant:** In general, the required minimum distribution is calculated using the IRA participant's attained age and a minimum distribution factor table prescribed by the IRS, the Uniform Lifetime Table.[1]

- **Spouse more than 10 years younger:** If the participant's spouse is more than 10 years younger than the participant and the spouse is the IRA's sole designated beneficiary for the entire calendar year, the minimum distribution factor used in calculating the required distribution amount is determined in accordance with the Joint and Last Survivor Table specified in Treas. Reg. 1.401(a)(9)-9, Q&A3. The participant's marital status is determined on January 1 of the calendar year.

- **RMD requirement waived for 2020:** The Coronavirus Aid, Relief, and Economic Security (CARES) Act waives the requirement that a taxpayer take an RMD during 2020.

- **Coronavirus-related distribution (CRD):** One section of the Coronavirus Aid, Relief, and Economic Security (CARES) Act provides for a "Coronavirus-related distribution," or CRD. A CRD – optional (not mandatory) for a qualified retirement plan sponsor - is a distribution made from January 1, 2020 through December 30, 2020 from an IRA or qualified retirement plan. A CRD may not exceed $100,000 in aggregate per individual, is exempt from the usual 20% mandatory federal tax withholding, and must be made to an individual (or spouse or dependent) who has been diagnosed with SARS-CoV-2 or COVID-19, or who has experienced an adverse financial consequence as a result of the COVID-19 pandemic. A CRD is exempt from any 10% early withdrawal penalty that may apply and, unless the individual chooses otherwise, the CRD will be included in taxable income ratably over a three-year period. The CRD may be re-paid, without regard to the normal contribution limits, over a three-year period.

- **Taxation of distributions.**

  - **During life:** Distributions are taxable as ordinary income.[2]

  - **At death:** At the IRA account owner's death, the distributions received by a beneficiary are generally taxed as ordinary income. A surviving spouse may elect to

[1] See Treas. Reg. Sec. 1.401(a)(9)-5, Q&A4(a).

[2] Taxes and penalties do not apply to nondeductible contributions.

receive distributions from an inherited IRA over his or her life expectancy. For most non-spouse beneficiaries, IRA balances must be completely distributed over a period of time not to exceed 10 years. In addition to surviving spouses, an exception to the 10-year rule applies to disabled or chronically ill individuals, to someone who is not more than 10 years younger than the IRA owner, or to a minor child of the IRA owner. Once a minor child reaches the age of majority (18 in many states), the requirement to completely distribute any remaining balance in the IRA over no more than 10 years applies.[1]

- **Qualified charitable distribution (QCD)**: Federal income tax law provides for an exclusion from gross income of up to $100,000 for distributions made from a Roth or traditional IRA *directly* to a qualified charitable organization. The amount excluded from gross income may be reduced if an individual continues to make deductible IRA contributions after reaching age 70½. If applicable, a QCD counts towards the taxpayer's RMD requirements. The IRA owner (or beneficiary of an inherited IRA) must be at least age 70½ when the distribution is made. No charitable deduction is allowed for a QCD.

- **Transfers to Health Savings Accounts (HSAs):** Federal law allows for a limited, one-time, direct transfer of funds from an IRA to an HSA. If certain requirements are met, any otherwise taxable portion of the distribution is excluded from income and the 10% early distribution penalty will not apply.

Investment Alternatives

- **Banks, savings and loans, credit unions:** Certificates of deposit in Traditional IRAs are generally protected by either the FDIC or the NCUA for amounts up to $250,000. Fixed and variable rates are available. There may be penalties for early withdrawal.

- **Annuities:** Traditional individual retirement annuities issued by insurance companies can guarantee a fixed monthly income at retirement.[2] Variable annuities do not guarantee a fixed monthly income at retirement.

[1] These distribution requirements generally apply to individuals who die *after* December 31, 2019. A different set of distribution requirements apply to individuals who died *before* January 1, 2020.

[2] Annuity guarantees are based on the claims-paying ability of the issuing insurance company.

- **Money market:** Yield fluctuates with the economy. Investor cannot lock in the higher interest rates. It is easy to switch to other investments.
- **Mutual funds and Exchange-Traded Funds (ETFs):** Capital gains, interest and dividends are tax-deferred in an IRA but are taxed as ordinary income at withdrawal.
- **Zero coupon bonds:** Generally purchased at a deep discount from face value, "zeros" are subject to both inflation risk and interest rate risk.
- **Stocks and bonds:** A wide variety of investments and risk is possible. Capital gains are taxed as ordinary income at withdrawal. Losses are generally not deductible.
- **Limited partnerships:** Some limited partnerships are especially designed for qualified plans, specifically in the areas of real estate and mortgage pools.

Prohibited Investments or Transactions for IRAs

- **Life insurance:** IRAs cannot include life insurance contracts.
- **Collectibles:** The purchase of art works, antiques, metals, gems, stamps, etc. will be treated as a taxable distribution. Coins issued under state law and certain U.S. gold, silver, and platinum coins are exceptions; some kinds of bullion may be purchased.
- **Loans to IRA taxpayer:** Self-borrowing disqualifies the IRA and triggers a constructive distribution of the fair market value of the entire amount in the IRA as of the first day of the tax year. Amounts so distributed are included in gross income. This is true whether the IRA is an individual retirement account or an individual retirement annuity. If the owner is under age 59½ at the time of a deemed distribution, a 10% tax penalty for early withdrawal will be added, unless an exception applies.
- **IRA as collateral:** If the owner of an individual retirement account pledges any portion of the account as security for a loan, the portion so pledged is deemed distributed, and included in gross income, as of the first day of the tax year in which the loan is made. If the owner of an individual retirement annuity pledges any portion of the contract as security of a loan, the fair market value of the entire amount in the account is deemed distributed, and included in gross income, as of the first day of the tax year. In both situations, if the owner is under age 59½ at the time of a deemed distribution, a 10% tax penalty for early withdrawal will be added, unless an exception applies.

Other Factors to Consider

- Is the interest rate fixed or variable? If interest rates drop, a fixed rate is better, especially if you can make future contributions at the same fixed rate. If interest rates go up, you may be able to roll the current IRA over to another IRA.
- What is the yield? More frequent compounding will produce a higher return.
- How often can you change investments? What is the charge?
- Federal bankruptcy law protects assets in traditional IRA accounts, up to $1,362,800.[1] Funds rolled over from qualified plans, however, are protected without limit

[1] Effective April 1, 2019. The limit is indexed for inflation every three years.