EA Tax Training

EA Exam Preparation 2025
Part 1: Individuals

VIDEO 6:

RETIREMENT ACCOUNTS AND SOCIAL SECURITY

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What We'll Cover

- Individual Retirement Arrangements (IRAs)
- Income from retirement plans
- Social Security income

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Free Resources (irs.gov)

- **Publication 17, *Your Federal Income Tax***
- **Instructions for Forms 1040 and 1040-SR**
- **Publication 590-A, *Contributions to Individual Retirement Arrangements (IRAs)***
- **Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAs)***
- Publication 575, *Pension and Annuity Income*
- Publication 939, *General Rule for Pensions and Annuities*

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Individual Retirement Arrangements (IRAs)

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IRAs- Overview

- An IRA is a personal savings plan (account or annuity) that gives you tax advantages for setting aside money for your retirement.
- Two basic types of IRAs:
  - Traditional IRA, which (usually) features a tax deduction for contributions and tax deferred growth, but is taxable when distributed. (Tax benefit is NOW).
  - Roth IRA, which features nondeductible contributions, tax free growth, and tax-free distributions. (Tax benefit is LATER).
- There are also IRAs for small businesses (SEPs, SIMPLE), which will be discussed in Part 2 of this series (Business taxation).

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Traditional IRAs

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Traditional IRA

- Two advantages

1. Deduct contributions (if you qualify).
   - Adjustment to income
2. Earnings are not taxed until distributed (tax-deferred growth).

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Traditional IRA

- In order to open or contribute to an IRA, you must have compensation (e.g. wages or self-employment income).
- Can be opened with a bank, mutual fund, life insurance company, stockbroker, etc.
- No age limit for making contributions

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Traditional IRA

- For 2024, the most that can be contributed is the lesser of:
  - $7,000 ($8,000 if age 50 or older), or
  - Total taxable compensation for you and your spouse, reduced by:
    - Spouse's contributions to a traditional IRA
    - Contributions on your spouse's behalf to a Roth IRA
- So the maximum contribution for a married couple is $14,000 (or $15,000 if one is age 50 or older, and $16,000 if both are).
  - Not necessary for both spouses to have compensation (MFJ).
- These limits apply to all IRAs you and your spouse own combined, whether traditional or Roth.

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Traditional IRA

- Contributions can be made any time during the calendar year, or by the due date of the tax return (i.e. April 15, 2025).
  - This is a way to save your clients taxes even after the year is over.
- You can file your return claiming the deduction even before the contribution is actually made.
  - For example, file and claim the deduction on March 1, 2025, and make the contribution on April 15, 2025.
- You do not have to contribute every year.

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Traditional IRA

- There are some limitations on who can make deductible contributions. These limitations depend on:
  - Whether or not you or your spouse are covered by an employer's retirement plan,
  - Your filing status, and
  - Your modified Adjusted Gross Income (MAGI)
    - AGI plus excluded foreign earned income

Traditional IRA

Effect of Modified AGI on Deduction if You Are Covered by Retirement Plan at Work for 2024

Filing Status	Modified AGI	Deduction?
Single	$77,000 or less	Full deduction
or	>$77,000 but <$87,000	Partial deduction
Head of Household	$87,000 or more	No deduction
Married filing jointly	$123,000 or less	Full deduction
or	>$123,000 but <$143,000	Partial deduction
Qualifying surviving spouse	$143,000 or more	No deduction
Married filing	Less than $10,000	Partial deduction
separately	$10,000 or more	No deduction

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Traditional IRA

Effect of Modified AGI on Deduction if You Are Not Covered by Retirement Plan at Work for 2024

Filing Status	Modified AGI	Deduction?
Single, Head of Household, or Qualifying Surviving Spouse	Any amount	Full deduction
Married filing jointly or separately with a spouse who **isn't** covered by a plan at work	Any amount	Full deduction
Married filing jointly with a spouse who **is** covered by a plan at work	$230,000 or less	Full deduction
	>$230,000 but <$240,000	Partial deduction
	$240,000 or more	No deduction
Married filing separately with a spouse who **is** covered by a plan at work	Less than $10,000	Partial deduction
	$10,000 or more	No deduction

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Traditional IRA

- Nondeductible contributions
  - Can still contribute up to the annual limit (e.g. $7,000 or $8,000) even if you don't meet the rules for deductibility
  - Any amounts in excess of what is deductible will be considered nondeductible
    - When you take distributions (e.g. at retirement), part of each distribution will be taxable and part nontaxable. Your nondeductible contributions (i.e. your basis) will not be taxed, but your deductible contributions and ALL earnings will be taxed.
  - Must report nondeductible contributions on Form 8606 for the year(s) it is made. (Must file even if not required to file an income tax return.)

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Traditional IRA Rollovers

- Transferring money from other retirement plans into a traditional IRA (e.g. 401(k) to IRA, IRA to IRA)
- Trustee-to-trustee transfer
  - Tax-free
- Rollover
  - Retirement plan sends you a check in your name, withholding 20% for taxes (no mandatory withholding if IRA to IRA)
  - You deposit the full amount (before withholding) into a new or existing IRA, **within 60 days**
  - Tax-free
  - If IRA to IRA, must wait one year before doing another rollover (does not apply if trustee-to-trustee)
- Transfer incident to divorce is tax free

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Traditional IRA Distributions

- In general, you pay tax at your regular income tax rates when you withdraw funds from a traditional IRA.
  - If you have basis in the IRA (e.g. as the result of making nondeductible contributions), part of the distribution will be taxable and part will not, in proportion to your basis.
  - No capital gains rates
- In addition, if you take a distribution before age $59^{1/2}$, you are generally subject to a 10% penalty.

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Traditional IRA Distributions

- When are distributions not taxable?
  - Rollovers
  - Qualified Charitable Distributions (QCDs)
    - Distributions directly from your IRA trustee to an eligible organization
    - Up to $105,000 per person, per year
    - Must be at least age 70½
  - Tax free withdrawals of contributions
    - When you make a contribution and the take it back out in the same year (or by the extended due date of your return).
    - Taxed on any earnings.
  - The portion attributable to nondeductible contributions is not taxable.

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Qualified Disaster Recovery Distributions

- Qualified disaster recovery distributions receive special tax treatment
- To qualify, must have suffered a loss due to living in a federally declared disaster area
- Maximum distribution is $22,000 (total from all retirement accounts) per disaster
- Included in income equally over 3 years, though the taxpayer can elect to include it all in the year received
- No 10% penalty for early withdrawal
- Can pay the money back into the account and reverse the income (may need to amend)

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Required Minimum Distributions

- Required minimum distributions (RMDs)
  - If you are the account owner (as opposed to a beneficiary), you must begin taking RMDs by April 1 of the year following the year you turn 73.
  - After that initial requirement, RMDs must be made by December 31 of each year.
  - RMDs are not eligible to be rolled-over
  - Qualified Charitable Distributions (QCDs) count toward your RMD.
  - If you do not take your (full) RMD, you may be subject to a penalty equal to 25% of the amount that should have been distributed but wasn't.
    - Can be reduced to 10% if corrected within two years after the year of the shortfall.
- The amount of the RMD is calculated based on the account balance and IRS life expectancy tables. See Publication 590-B.

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Traditional IRA Distributions

- Distributions are reported on Form 1099-R.
- Federal income tax is withheld unless you choose otherwise.
- Must file Form 8606 when you receive a distribution if:
  - You ever made nondeductible contributions, or
  - You ever rolled-over after-tax amounts to the traditional IRA

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Roth IRAs

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Roth IRA

- While you receive no tax deduction for contributing to a Roth IRA, there are very significant tax advantages:
  1. The investment grows tax free (no taxes each year on earnings).
  2. When the funds are distributed to you at retirement, they are (generally) completely tax-free.
- No RMDs while the account owner is alive.

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Roth IRA

- In order to open or contribute to an IRA, you must have compensation (e.g. wages or self-employment income).
- Can be opened with a bank, mutual fund, life insurance company, stockbroker, etc.
- No age limit for making contributions
- Contributions can be made any time during the calendar year, or by the due date of the tax return (i.e. April 15, 2025).

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Roth IRA

- For 2024, the most that can be contributed is the lesser of:
  - \$7,000 (\$8,000 if age 50 or older), or
  - Total taxable compensation for you and your spouse, reduced by:
    - Spouse's contributions to a traditional IRA
    - Contributions on your spouse's behalf to a Roth IRA
- So the maximum contribution for a married couple is \$14,000 (or \$15,000 if one is age 50 or older, and \$16,000 if both are).
- These limits apply to all IRAs you and your spouse own combined, whether traditional or Roth.

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Roth IRA

- If your modified AGI is above certain limits, the amount of your maximum contribution is gradually reduced. The amount of the reduction depends on:
  - Filing status
  - Modified AGI
- Unlike traditional IRAs, whether or not you participate in a retirement plan at work does not matter.

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Roth IRA

Effect of Modified AGI on Roth IRA Contribution 2024

Filing Status	Modified AGI	Contribution?
Married filing jointly	Less than $230,000	Up to $7,000 ($8,000 age 50 or older)
or	>=$230,000 but <$240,000	Reduced contribution
Qualifying surviving spouse	$240,000 or more	No contribution
Married filing separately	Zero (-0-)	Up to $7,000 ($8,000 age 50 or older)
and you lived with your spouse	>Zero (-0-) but <$10,000	Reduced contribution
at any time during the year	$10,000 or more	No contribution
Single, HOH, or MFS and didn't	Less than $146,000	Up to $7,000 ($8,000 age 50 or older)
live with your spouse at any time	>=$146,000 but <$161,000	Reduced contribution
during the year	$161,000 or more	No contribution

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Roth IRA- Distributions

- Distributions of amounts contributed are always tax and penalty free.
- Distributions of earnings are tax and penalty free it the account is at least 5 years old and recipient is:
  - Age $59^{1/2}$ or older,
  - Disabled,
  - A beneficiary of a deceased account owner, or
  - Using the funds for buying a first home (up to $10,000)
- Other distributions of earnings are subject to tax and 10% penalty.

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Recharacterizations

- You may be able to treat a contribution made to one type of IRA as having been made to a different type of IRA.
- Must be a trustee-to-trustee transfer made by the due date (including extensions) of the return for the year during which the original contribution was made.
- All earnings are also transferred, and the date of the transfer becomes the contribution date.
- Report on Form 8606.

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Recharacterization Example

- **Example:** Dean makes a $5,000 contribution to his traditional IRA on August 1, 2024. In February of 2025, he meets with his tax preparer, who informs him that due to an increase in his salary, Dean does not qualify for an IRA deduction for 2024. On February 15, 2025, Dean notifies the IRA trustee to transfer the contribution and any earnings into a Roth IRA, which is done the same day. He reports this on Form 8606, and it will be treated as a 2024 Roth contribution made on February 15, 2025, and the original contribution to the traditional IRA will be ignored.

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Roth IRA- Conversions

- Conversion of a traditional IRA to a Roth IRA.
  - Treated as a rollover, regardless of the conversion method used.
  - Rollover rules apply, except the 1 year waiting period.
- Pay tax on the taxable portion of the distribution from the traditional IRA, but no 10% penalty for early withdrawal.
- Can be done via:
  - Rollover (check made out to account holder, who then reinvests within 60 days).
  - Trustee-to-trustee.
  - Same trustee transfer.

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Roth IRA- Conversions

- Conversion from a SIMPLE IRA to a Roth IRA.
- Cannot convert any amount distributed from the SIMPLE IRA plan during the first two years you participated in the plan.
- Pay tax on the taxable portion of the distribution from the traditional IRA, but no 10% penalty for early withdrawal.
- Can be done via:
  - Rollover (check made out to account holder, who then reinvests within 60 days).
  - Trustee-to-trustee.
  - Same trustee transfer.

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Roth IRA- Rollover

- Rollover from a traditional qualified retirement plan (401(k), 403(b), 457, etc.) to a Roth IRA.
- Pay tax on the taxable portion (in excess of basis) of the distribution from the retirement plan, but no 10% penalty for early withdrawal.
- Can be done via:
  - Rollover (check made out to account holder, who then reinvests within 60 days).
  - Trustee-to-trustee.
  - Same trustee transfer.

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Roth to Roth Rollover

- You can withdraw, tax free, all or part of the assets from one Roth IRA if you contribute them to another Roth within 60 days.
- Same general rules as other IRA to IRA rollovers.

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Other IRA Rules

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Prohibited Transactions, etc.

- If you don't follow the rules, you can incur penalties or owe additional taxes.
- There are two general categories: 1. Prohibited transactions and 2. Other disallowed activities

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Prohibited Transactions

- A prohibited transaction is any improper use of your IRA by you, your beneficiary, or any disqualified person (e.g. your fiduciary and family members).
- The following are examples of prohibited transactions with an IRA:
  - Borrowing money from it
  - Selling property to it
  - Using it as security for a loan
  - Buying property for personal use (present or future)

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Prohibited Transactions

- If the owner or their beneficiary engages in a prohibited transaction, it has the following effects:
  - The account stops being an IRA as of the first day of that year
  - The account is treated as distributing all its assets at their fair market values on the first day of the year. In addition to regular income tax, there may be additional taxes or penalties.
- If someone other than the owner or a beneficiary engages in a prohibited transaction, that person may be liable for certain taxes. In general, there is an initial 15% tax on the amount of the prohibited transaction and a 100% additional tax if the transaction isn't corrected.

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Other Disallowed Activities

- Other disallowed activities:
  - Investing in collectibles
    - Considered distributed to you in the year purchased
  - Having unrelated business income
    - Pay tax at Trust tax rates
  - Making excess contributions
    - If not withdrawn by the due date (including extensions) of the return, must pay a 6% tax on the excess contributions each year they remain in the account
      - Roth IRA- Can designate excess as next year's contribution
  - Failing to take required minimum distributions
  - Taking early distributions (10% penalty)

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Early Distribution Penalty Exceptions

- For unreimbursed medical expenses that are more than 7.5% of AGI
- For certain health insurance premiums after you have received unemployment compensation (or would have been eligible to receive unemployment compensation but for your self-employed status)
- Made because you're totally and permanently disabled
- Made to you because you are terminally ill
- Made to a beneficiary or estate on account of the IRA owner's death
- You are receiving the distributions as part of an annuity.

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Early Distribution Penalty Exceptions

- For qualified higher education expenses
- Not in excess of $10,000 used in a qualified first-time home purchase
- Made directly to the government to satisfy an IRS levy of the IRA under section 6331 of the Code
- A qualified reservist distribution
- Not in excess of $5,000 and the distribution is a qualified birth or adoption distribution
- Excepted from the additional income tax by federal legislation relating to certain emergencies and disasters

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Early Distribution Penalty Exceptions

- One-time qualified HSA distribution, used to fund HSA account.
- Domestic abuse distribution up to $10,000 (**New for 2024**)
  - Within 1 year of becoming a victim
  - Can be repaid within 3 years
- Emergency personal expense distribution up to $1,000 (**New for 2024**)
  - Unforeseeable or immediate financial needs
  - Once per year
  - Can repay within 3 years

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Inherited IRA

- If inherited from a spouse, you have three options:
  1. Treat it as your own IRA by designating yourself as the owner.
  2. Treat it as your own by rolling over into your IRA or other retirement account (401(k), 403(b), 457, etc.).
  3. Treat yourself as a non-spouse beneficiary rather than an owner.

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Inherited IRA

- If inherited from someone other than a spouse (e.g. a parent):
  - You cannot treat the IRA as your own.
  - You can take the money and pay any tax now (but not the 10% penalty for early withdrawals), or
  - You can roll into another IRA in the name of the deceased person. You must take distributions each year, and completely deplete the account within 10 years (again, no early withdrawal penalty).

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Inherited IRA RMDs

- Required minimum distributions (RMDs) are required for all inherited IRAs, including Roths.
- For a beneficiary of an inherited account, the RMD depends on whether:
  - The beneficiary is the surviving spouse
  - The beneficiary is an eligible designated beneficiary (e.g. minor child, disabled or chronically ill child) other than the spouse
  - The beneficiary is an individual or a trust
  - The IRA owner died before or after the required beginning date for distributions
- In most cases, for individuals who are <u>not</u> a spouse or eligible designated beneficiary, the 10-year rule applies
  - Must completely deplete the account within 10 years (no early withdrawal penalty), and if the account holder reached RMD age, beneficiary must take distributions each year.

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Inherited IRA RMDs

- For spouses and eligible beneficiaries, typical options are:
  1. Rollover the account into their own IRA, and follow the regular RMD rules based on their own age, or
  2. Keep the account and delay distributions until the account holder would have been 73. They then take distributions based on their own life expectancy; or
  3. Follow the 10-year rule discussed earlier; or
  4. Take a lump sum distribution and pay tax on any taxable amount.
- If the account holder was required to take RMDs and did not in the year of death, the beneficiary must take an RMD on their behalf.

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Income from Retirement Plans

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Income from Retirement Plans

- Distributions from retirement accounts should be reported to the recipient on Form 1099-R.
- The 1099-R should report how much of the distribution is taxable, but sometimes it does not.
- If you did not make post-tax contributions to the plan, it is usually all taxable.
- You can compute the taxable component yourself, usually using the "Simplified Method" shown in the 1040 instructions.
  - Taxpayers with pensions that started paying before July 1, 1986, can use the "General Rule" found in Publication 939.
- The IRS will compute the taxable portion for you, but there is a $1,000 fee.

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Income from Retirement Plans

- Most of the rules for distributions from IRAs also apply to distributions from employer retirement accounts.
  - Distributions before age $59^{1/2}$ usually result in a 10% penalty, unless an exception is met.
  - Amounts can be transferred to another retirement account or rolled over.
  - Required minimum distributions must start by April 1 of the year after you turn 73 (except for Roth type plans)
  - Etc.
- If the plan allows it, you can borrow from many employer plans, and as long as you pay it back on schedule, it is not a distribution and is not taxed.

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Social Security Income

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Social Security Income

- Social security income is reported to the recipient on Form SSA-1099, box 5.
- Income from social security may be tax free, or may be partially taxable, depending on your other income. In any case, no more than 85% is taxable.

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Social Security Income

- To determine if any of your social security benefits are taxable, you add up:
  - ½ of your social security income, plus
  - your other income, including tax-exempt interest
- And compare it to your "base amount"
  - S, HOH, QSS: $25,000
  - MFS, lived apart all yr.: $25,000
  - MFJ $32,000
  - MFS, lived together: $-0-

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Social Security Income

- If your computed income is less than your base amount, none of the social security benefits are taxable.
- If more than your base amount, part of the benefits are taxable.
- There are worksheets in the Form 1040 Instructions to use to determine how much is taxable.

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Social Security Income

- **Example:** Flo and Joseph are married and file a joint return. Flo received $18,000 in social security, and Joseph received $14,000. Flo also received a pension of $1,000 per month, and had tax-exempt interest of $3,000. Half their social security equals $16,000, the pension is $12,000, and the tax-exempt interest is $3,000, for a total of $31,000. They have no other income. Since their base amount is $32,000, none of their social security benefits are taxable.

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End of Video 6. See you in Video 7!

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