

Tricks and Traps of IRAs



SPIDELL
TAX • ANALYSIS • EDUCATION

www.caltax.com | E-mail: CPE@spidell.com | Phone: 714-776-7850 | Fax: 714-776-9906

YOUR CALIFORNIA SOLUTION SINCE 1975

This publication is distributed with the understanding that the authors and publisher are not engaged in rendering legal, accounting or other professional advice and assume no liability in connection with its use. Tax laws are constantly changing and are subject to differing interpretation. In addition, the facts and circumstances in your particular situation may not be the same as those presented here. Therefore, we urge you to do additional research and ensure that you are fully informed before using the information contained in this publication. Federal law prohibits unauthorized reproduction of the material in Spidell's **Tricks and Traps of IRAs** manual. All reproduction must be approved in writing by **Spidell Publishing, Inc.**

This is not a free publication. Purchase of this electronic publication entitles the buyer to keep one copy on his/her computer and to print out one copy only. Printing out more than one copy — and any electronic distribution of this publication — is prohibited by international and United States copyright laws and treaties. Illegal distribution of this publication will subject the purchaser to penalties of up to \$100,000 per copy distributed.

Table of Contents

Introduction	1
What are the benefits of an IRA?	2
Crunching the numbers.....	2
Bankruptcy protection.....	3
Starting an IRA.....	7
Setting up the account	7
What is an IRA?	7
Types of IRAs.....	7
“myRA” accounts.....	8
Program being phased out.....	8
Roth versus traditional.....	9
Basic considerations	9
Roth versus traditional – an in-depth look at the math	10
Nondeductible IRAs	13
The Saver’s Credit.....	14
Likely candidates.....	15
Don’t overlook seniors.....	15
Contributing to an IRA.....	17
Basic rules.....	17
Due date of contributions.....	17
Cash only	17
Maximum amount.....	17
Taxable compensation for purposes of the maximum contribution amount	18
Spousal IRA	19
Active participation at employment.....	20
Defined benefit plan.....	20
Defined contribution plan.....	20
Tax Court case highlights active participation rules	21
Taxpayer could have suspended benefits.....	21
No IRA allowed even with minimal employer contributions	21
No IRA deduction even when employee didn’t realize he was part of a plan.....	21
AGI phaseout ranges	21
How modified AGI is computed.....	23
Getting out of the plan.....	23
Excess contributions	24
Withdraw excess by due date of return	24
Withdraw excess after due date of return.....	26
Carryover excess.....	26

Planning for the penalties	26
Specific contribution rules for each of the three types of IRAs.....	28
The traditional deductible IRA.....	28
The nondeductible IRA	28
The Roth IRA	31
Investing	32
Smart investing in an IRA.....	32
Annuities in the IRA	33
Negatives for annuities.....	33
Benefits of annuities.....	34
Lifetime income stream	34
Longevity contracts?	34
Annuity benefits today.....	34
Prohibited investments and transactions.....	35
Pledging the IRA	35
Collectibles	35
Buying a home	35
Prohibited transactions.....	36
Nontraditional investments in general – advantages and disadvantages	39
Investing in real estate.....	39
How it works	39
Hurdles	40
Getting over the hurdles.....	41
Other considerations.....	41
IRA LLCs	42
How the LLC comes into play	42
IRA LLC structure – advantages and disadvantages	42
Summary and recommendations.....	42
Rollovers for business startups	42
Oversight	43
Consequences of invalid transaction.....	43
Prohibited transaction cases	43
Other ROBS noncompliance traps	44
ROBS successes.....	44
Investing in gold.....	45
Wash sale rules and IRAs.....	45
Unrelated business taxable income.....	45
When does tax apply?.....	46
Investments that may generate UBTI.....	46
Taxable income	46

Excludable income	46
Exceptions	47
Tax rates.....	47
Filing	47
Paying tax.....	47
State liability.....	48
Resident or nonresident?.....	48
IRA losses not deductible by IRA owner	49
Paying investment fees	50
Traditional IRAs	50
Roth IRAs	50
Rolling Over (Into and Out of an IRA).....	51
Early withdrawal penalty/additional tax	51
IRS may question 1099.....	51
IRA-to-IRA rollovers	52
Only one rollover is allowed per year.....	52
Partial rollovers	53
Rollover from an IRA to a qualified plan	53
Rollover from a qualified plan to an IRA	54
Withholding.....	54
Choosing the rollover option.....	54
Qualified rollovers	56
Substantially equal periodic payments	56
Required minimum distributions	56
Comparison chart of allowable rollovers.....	58
When not to roll over from a qualified plan.....	59
Participant age 55 or older	59
Net unrealized appreciation	60
The 60-day requirement	62
Under what circumstances will the IRS grant relief?	63
Applying for waiver	63
Self-certification process for failed IRA rollovers	65
Taxpayer granted waiver of 60-day rollover period for promissory note	68
Taxpayer is disabled and not subject to 10% penalty.....	68
No exception to early withdrawal penalty for prior-year medical expenses	68
No rollover waiver for unsubstantiated medical condition.....	68
Gambling addict steals from his wife’s IRA	69
Wife receives 60-day rollover waiver, husband not so lucky	69
No relief for failed IRA rollover	69

Converting, Recharacterizing, and Reverting	70
Why do it?	70
Converting	70
AGI limitations	71
Five-year rule	71
Income recognition.....	71
Valuing an annuity for conversion purposes	71
Partial conversions	72
Timing.....	73
Converting from other retirement plans.....	73
Reporting requirements	74
Conversions post-2009.....	74
<i>De facto</i> elimination of Roth contribution AGI limitations?	74
Roth conversion checklist	75
Recharacterizing.....	77
Requirements	77
Trustee-to-trustee transfer.....	77
Transfer contribution plus allocable income	78
Making a timely election	78
Amended returns	78
Reporting recharacterizations.....	79
Nonautomatic extensions.....	79
Tax Reform changes to recharacterizations.....	80
Taxpayers should plan carefully before converting now	81
California conformity	81
Planning, generally	81
NOL opportunity	82
Using charitable contributions	82
AGI and passive losses	83
Social Security taxability	83
Medicare	83
Estate planning issues.....	85
Distributing	86
Spending isn't so simple	86
General rules on distributions.....	86
Traditional IRAs	86
Nondeductible contributions.....	87
Roth IRAs	87
Transfers incident to divorce	87

Nondeductible IRA distributions	87
Computing the tax-free portion (basis) of the distribution	87
Documenting the tax-free portion of the distribution.....	88
Roth IRAs	89
The five-year rule	89
Roth distribution ordering rules	90
Premature distributions – the 10% penalty	91
Exception for medical purposes.....	91
Exception for educational purposes	92
Exception for first-time homebuyers.....	92
Substantially equal periodic payments.....	94
Payment methods.....	95
No modifications allowed.....	95
Exceptions to modification rules.....	96
Other modifications	97
Special tax-free distributions	99
Distributions to fund a health savings account.....	99
Qualified charitable distributions	99
Transfer of IRA funds directly to charity: old planning opportunity with new significance under the TCJA.....	101
California conformity	102
Required minimum distributions	102
How is RMD calculated?.....	102
Notes regarding the RMD calculation.....	104
When must RMD begin?	104
Penalty for failure to take RMDs.....	104
Distribution planning ideas.....	104
Taking a deduction for IRA losses	104
RMDs in a market decline.....	105
Pushing forward the RMDs.....	106
QLAC requirements.....	106
Taking distributions early	107
Leaving Behind and Inheriting.....	108
Who gets the IRA?.....	108
Beneficiary designation takes precedence over divorce decree, but estate may sue	108
Estate tax	109
Treatment of an inherited IRA	109
Taxability	111
Roth IRAs	111
Surviving spouse as beneficiary.....	111

Nonspouse individual as beneficiary	113
Trust as IRA beneficiary	114
Partial disclaimer of IRA proceeds	116
Failure to take required distributions.....	118
Rollovers from qualified plans.....	118