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Little-Known Ideas for IRAs

Individual Retirement Accounts (IRA) can be powerful tools for retirement savings but using them effectively can present complex challenges. The first step is knowing these strategies exist.

SOME IRA BASICS

Money contributed to traditional IRAs are not generally taxed in the year of contribution unless the contributor also participates in a qualified retirement plan at work (with income limitations). This pre-tax money will be tax-deferred as long as it remains in retirement accounts—all taxes are due when distributed.

Roth IRAs are funded with after-tax dollars instead. Contributions have the potential to grow tax-deferred like the traditional IRAs however, if the rules are followed in retirement, the distributions are tax-free. There are income limitations on contributors to Roth IRAs regardless of participation in qualified retirement plans.

ROTH IRAS FOR THOSE WITH HIGHER INCOMES

Depending on a number of factors, an IRA participant may receive a greater tax benefit either deferring taxes during working years or receiving tax-free income in retirement. Once retired, most participants enjoy tax-free income. For one thing, qualified Roth IRA distributions aren't counted for taxation of Social Security benefits. However, income limitations prevent most high earners from participating.

Everyone, regardless of income, may contribute to traditional IRAs. However, as mentioned above, when participating in qualified business retirement plans, contributions to traditional IRAs are not tax-deductible for high-earners. Due to recent changes to tax codes, these after-tax dollars may be converted immediately to Roth IRA assets—monthly, if desired. Those with high incomes are now able to build Roth IRA balances.

DELAYING SOME RMDS WITH THE QLAC

Required Minimum Distributions, often referred to as RMDs are amounts the federal government requires investors to remove from traditional IRAs and employer-sponsored retirement plans after reaching the age of 70½. Investors can always take more than the minimum but will be heavily penalized if required amounts are not removed. RMD rules do not apply to Roth accounts unless inherited.

A participant may be able to use up to 25% of non-Roth IRA and retirement plan account balances (up to a maximum of $130,000 from all accounts, indexed for inflation) to purchase a qualified longevity annuity contract (QLAC). A QLAC is a deferred income annuity and the value of the QLAC is disregarded when calculating annual RMDs. Payments from the QLAC may be delayed up to age 85 and are treated as satisfying RMD rules when paid out.

QUALIFIED CHARITABLE DISTRIBUTIONS-QCD

The Pension Protection Act of 2006 first allowed taxpayers age 70½ or older to make tax-free charitable donations directly from their IRAs. These taxpayers were allowed to exclude from gross income otherwise taxable distributions from their IRA ("qualified charitable distributions," or QCDs), up to $100,000, that were paid directly to a qualified charity. These gifts are also known as "Charitable IRA rollovers." The law was originally scheduled to expire in 2007, but was extended periodically through 2014 by subsequent legislation, and finally made permanent by the Protect Americans from Tax Hikes (PATH) Act of 2015.

The IRA trustee makes a distribution *directly* from the IRA (other than SEP and SIMPLE IRAs) to a qualified charity. The distribution must be one that would otherwise be taxable. Up to $100,000 of QCDs may be excluded from gross income each year, thereby avoiding taxation on those amounts. If filing a joint return, a spouse may exclude an additional $100,000 of QCDs. Note: QCDs may not also be deducted as charitable contributions on federal income tax returns—that would be double-dipping.

QCDs count toward satisfying RMDs that would otherwise have to be received from an IRA, just as if an actual distribution had been received from the plan. However, distributions actually received from an IRA (including RMDs) subsequently transferred to a charity do not qualify as QCDs.

MAKING A TAXABLE INHERITANCE TAX-FREE

All distributions from traditional IRAs and qualified business retirement plans are fully taxable to the recipient. This means beneficiaries of these accounts will have a significant tax bill if large amounts are removed each year.

If the original owner of the IRA doesn't need the income from RMDs and desires to pass on a legacy, consider buying life insurance with annual distributions. At death, heirs will receive what remains in the IRA and a tax-free insurance benefit. This strategy only works for those who qualify for affordable insurance coverage.

These strategies are more complex than space allows. Applying them to particular situations is a conversation to have in a consultation with a qualified professional.

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