Sy Accountancy Corporation
Member, American Institute of CPAs
704 Mira Monte Place, Pasadena, California 91101
Tel (626) 744-0200 • Fax (626) 744-0300 • vsy@victorsycpa.com • www.victorsycpa.com

IRA UPDATE

By Victor Sy, CPA, MBA

The traditional IRAs lost most of their luster as investment vehicles when Congress tinkered with income phase-outs and disqualifications. As a result, a lot of taxpayers were not able to avail of IRAs. For example, you could not deduct an IRA if your spouse is an active participant in a qualified retirement plan at work even if you are not. Higher- earning taxpayers were also phased out of IRA deductions.

That has changed in light of favorable new provisions:
1. You are not considered an active participant simply because your spouse is. This means that you can now open and contribute to your own IRA.
2. The income phase-out has been increased to allow more taxpayers to contribute to their IRAs.

Roth IRAs: Contributions are not deductible but earnings build up tax-free. You can eventually withdraw your money tax-free including earnings.

You may contribute $5,000 for 2011. Add another $1,000 for 2011 if you are 50 years or above. You have to reduce these amounts by contributions made to your regular IRA. Roth IRAs will probably become the ideal investment vehicles for short-term gains and ordinary income because gains and income will never be taxed.

You may convert regular IRAs into Roth accounts. Be careful though because such conversions are treated as distributions from regular IRAs. You could owe taxes. Conversions would make sense if you were in a low tax-bracket rate during the year. There are no penalties for distributions before age 59 ½ with respect to conversions.

If you think the conversion was not a good idea, you may also back out of Roth IRA by recharacterizing the new Roth into a traditional IRA. Move back the funds via a direct trustee-to-trustee transfer. This works before you file by the due date (plus extensions to October 15). If you already filed, amend your return to reflect the recharacterization.

Coverdell Education IRAs: The new Act established education IRAs where you could contribute $2,000 annually for each child. Earnings inside this education IRAs build up tax-free. At college time, tax-free withdrawals can be taken for post-secondary tuition, books, supplies, and room and board. TIP: You might have to start early because contributions to these education IRAs are allowed only before your children reach 18 years of age.

Penalty-free distributions for education expenses: Withdrawals from regular IRAs can be made to pay for higher education expenses for you, your spouse, your child or grandchild without having to pay the 10% penalty tax on withdrawals before age 59 and 1/2. (However, you will still owe the regular income tax).

Penalty-free distributions for first-time homebuyers: You can also withdraw IRA accounts if used to finance a first-time home purchase for you, your spouse, child, grandchild, or your ancestors. There is a $10,000 lifetime limit on these penalty-free withdrawals for home purchase. (TIP: It does not have to be your first home. You could have owned a home, as long as you didn't buy one in last two years).

Penalty-free substantially equal IRA payments: You can begin withdrawing funds before reaching age 59 ½ without penalty by taking substantially equal payments annually over your life.

Saver’s Credit: There's a Saver's Credit of 10% to 50% of the first $2,000 ($1,000 for all others) contributed to a traditional or ROTH IRA, 401(k), 403(b), or SEP. This credit is in addition to the deduction for your contribution.

New Law OKs IRA Rollover from deceased to non-spouse beneficiary. Old law permitted only spouse beneficiaries to rollover inherited IRAs.

Conclusion: With these new liberal rules for IRAs, it opens up doors for you to save for your retirement or for the education of members of your family. If you have always wanted to buy a house for you, your child, or grandparents but had no source of downpayment except IRAs, this is the time!