FIVE IMPORTANT IRA RULES YOU MAY BE UNAWARE OF

One of the most common vehicles used for saving for retirement is a Traditional IRA and a Roth IRA. These accounts are great due to the tax-advantaged components and are not employer-sponsored. Which means virtually anyone with earned income can open an IRA account and save for retirement. However, some rules you may be unaware of are extremely important when choosing between a Traditional and Roth IRA. Below, I will discuss five rules that I think are the most important but are not talked about enough.

1.The 5-Year Rule.

Contributions to a Roth IRA can be distributed to the original account holder at any time. This is because Roth IRA contributions are considered after-tax money. However, to withdraw earnings from your Roth without owing taxes or penalties, you have to be at least 59 ½ years old, and the account has to be five years old. Even if you're already 59 ½, you have to have established and held the Roth for at least five years. The 5-year clock starts ticking with your first contribution to any Roth IRA; this also applies to conversions from a Traditional IRA to a Roth IRA.

When I say "conversions," I am specifically referring to Roth conversions. Each conversion has its own five-year clock. Which means the oldest conversions are withdrawn first. The IRS considers the order of withdrawals for a Roth IRA as contributions first, followed by conversions, and then earnings. If you break the five-year rule, the IRS will deem your withdrawal an unqualified distribution. Unqualified distributions are subject to taxes at your current ordinary income tax rate plus a 10% penalty.

2. Phaseout Limits For Active Participants In An Employer Sponsored Plan.

You are considered an active participant if you currently participate in your employer-sponsored retirement plan, such as a 401(K) or 403(B). If your income is above a certain threshold, you are an active participant, and you contribute to a Traditional IRA, then you are unable to deduct your Traditional IRA contribution. A Traditional IRA is a pre-tax account, so normally, you can deduct what you put in since you are deferring taxation. It is important to note that this deductibility rule also applies to the active participant of a spousal IRA, but the income limits are much higher. The income thresholds for 2023 are as follows:

IRA Deduction Phaseout for Active Participants	
Single, Head of Household	$73,000 – $83,000
Married Filing Jointly	$116,000 – $136,000
Married Filing Separately	$0 – $10,000
Spousal IRA	$218,000 – $228,000

Couples who are married and filing jointly can take the full IRA deduction if neither spouse is covered by a retirement plan at work (the maximum is the annual contribution limit of $6,500 per individual). If one spouse participates in the plan, the income restrictions apply. A full deduction is available if your modified adjusted gross income is $218,000 or less for 2023. No deduction is available for incomes greater than $228,000 for 2023. If both spouses participate in the plan, the income thresholds are less advantageous, starting at $116,000 for 2023.

3. Phaseout Limits for Roth IRA Contributions.

Eligibility to contribute to a Roth IRA may be withdrawn depending on your overall income. The IRS sets income limits that restrict high-income earnings to contribute to a Roth IRA based on your modified adjusted gross income. If your income is above a certain threshold, you are actually ineligible to contribute to a Roth IRA. However, there are some strategies around this. But, generally speaking, here are the income thresholds for 2023:

Roth IRA Phaseout Income Limits	
Single	$138,000 – $153,000
Married Filing Jointly	$218,000 – $228,000
Married Filing Separately	$0 – $10,000

4. You must have earned income to contribute to a Traditional and Roth IRA.

One qualification to contribute to either type of IRA is you need to have earned income. The contribution limit is limited to the lesser of $6,500 or your total compensation. However, if you and a spouse file married filing jointly, the non-working spouse is eligible to contribute to an IRA. This means each spouse can contribute $6,500 to their own IRA. If you are age 50 and older, you are also eligible for an additional $1,000 contribution, referred to as the "catch-up" contribution.

5. If you have multiple IRAs, the contribution limit remains $6,500 in total.

It is common for people to save on a pre-tax and after-tax basis.
It's also great to have different buckets of tax money.
So, having both a Traditional IRA and a Roth IRA is not a bad thing!
It actually provides you with varying options of withdrawal for when you retire. Which, in return, allows you to manipulate your tax bracket when you are no longer working.

However, if you have more than one IRA, the aggregate annual contribution limit remains at $6,500 for individuals under age 50. You are not eligible to contribute $13,000 just because you have two different IRA accounts.
If you accidentally go over the annual limit, you must correct the contribution in the year the error was made. If you don't withdraw the excess amount, the IRS will charge you a 6% penalty tax on amounts over the annual limit.
If you are systematically contributing to an IRA, make sure your contributions don't exceed that limit by the end of the year.

These five IRA facts are so important but often overlooked because of the minutiae detail. Breaking one of these rules can cause you to owe more money to the IRS. So, it is vital to have a full, comprehensive understanding of the rules. We always watch out for these items so they won't go unnoticed. However, any personal investments should be analyzed to ensure you are within regulations.

Article by: Taylor Ledbetter
Wealth Advisor

jwm JESSUP WEALTH MANAGEMENT

Jessup Wealth Management does not provide tax, legal, or accounting advice. This material has been prepared for informational purposes only and is not meant to provide, and should not be used for, tax, legal, or accounting advice. You should consult your tax, legal, and accounting advisors before engaging in any transaction.
https://www.jessupwealthmanagement.com/disclosures-page