My Guide For

Individual Retirement Accounts

PALM CAPITAL MANAGEMENT

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Sources:
Kaplan, IRS.gov, Investopedia.com, Forbes.com, ThomsonReuters.com, TurboTax.Intuit.com

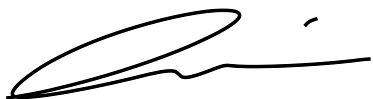
Dear Investor:

Thank you for downloading Palm Capital Management's "Guide To Individual Retirement Accounts". We believe this guide provides answers to frequently-asked questions in a manner that is straight-forward, comprehensive, and easy-to-understand.

I'd like to invite you to visit our website (PalmCM.com) where you can learn more about the professionals at our firm, along with our investment philosophy. In addition, please feel free to download other complimentary guides we've written on popular financial planning topics in our "Resources" section.

If you feel our firm might be a good fit for your long-term retirement planning and/or wealth management needs, please send an email to **info@palmcm.com**. A fiduciary advisor will be in contact within twenty-four hours to schedule an appointment.

Best Regards,



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Traditional IRA

What is it?

- A personal retirement vehicle for individuals that shelters earned income from taxation and defers taxes until funds are withdrawn.

Who is it meant for?

- Individuals who want a portion of their earned income sheltered and deferred until it is withdrawn from the account (tax-deferred growth).
- Individuals that need a supplement or alternative to a qualified company-sponsored plan.
- For 2024, eligible individuals may contribute up to $7,000 to an IRA and deduct this amount from their current taxable income, subject to phaseout rules. Individuals age 50 or older can make an additional “catch-up contribution” of $1,000.
- Any individual at any age may contribute to an IRA, provided he or she has earned income, or is the spouse of someone with enough earned income to cover the contribution.

What other important facts should I know?

- Loans are not permitted.
- Joint accounts are not permitted.
- Prohibited investments include life insurance and antiques/collectibles.
- Withdrawals will be subject to a 10% penalty if withdrawn before age 59 ½, unless the distribution is related to:
    - a death,
    - substantially equal payments,
    - disability,
    - first home expenses up to $10k,
    - qualified education expenses, or
    - medical expenses greater than 10% of Adjusted Gross Income (“AGI”).
- All withdrawals/distributions from IRAs are taxed as ordinary income in the year received.
- The age for taking Required Minimum Distributions (RMDs) in 2024 is 73.

- The contribution due date is generally the tax filing deadline of April 15.
- Excess contributions result in a penalty of 6% excise tax each year the excess amount is not withdrawn.
- Know the term “active participant”.
    - An individual who participates in a qualified company-sponsored retirement plan, 403(b) plan, Simplified Employee Pension (“SEP”) plan, or Savings Incentive Match Plan for Employees (“SIMPLE”) IRA is considered an active participant. Federal, state, and local government plans are also taken into account, but not 457 plans.
    - When Single taxpayers and both Married-Filing-Jointly (“MFJ”) spouses are not active participants, Traditional IRA contributions are fully deductible, regardless of the taxpayer’s Modified Adjusted Gross Income (“MAGI”).
    - For taxpayers who are active participants, the deduction for Traditional IRA contributions is limited (or eliminated) when a taxpayer’s MAGI reach phaseout levels of $77,000–$87,000 for Single, and $123,000–$143,000 for MFJ in 2024.
    - When a MFJ couple only has one spouse who is an active participant, the nonparticipant spouse will have the deduction phased out at MAGI levels between $230,000–$240,000 in 2024.

- Know the term “earned income”.
  - It does NOT include the following:
    - Earnings and profits from property such as rental income, interest income, dividend income, and investment income.
    - Pension or annuity income.
    - Compensation payments postponed from a previous year.
    - Foreign earned income.
    - Housing cost amounts, or any other amounts, that are excluded from income.

- Know the “aggregation rule”.
  - The IRS requires that all deductible and non-deductible Traditional IRAs be aggregated together, therefore treated as one Traditional IRA for the purpose of calculating the cost basis of a distribution.
  - Even if the nondeductible Traditional IRA contributions are separated in different IRAs from the deductible traditional IRA contributions, the aggregation rule still applies for both accounts, because they will be treated as one.
  - When calculating the nontaxable portion of the distributions made during a given tax year, all distributions in that year are also aggregated as though there was only one distribution in the year.

Roth IRA

What is it?

- A personal retirement vehicle that does NOT shelter earned income from being taxed but allows investment earnings to grow tax-free, assuming distributions are qualified.

Who is it meant for?

- Only taxpayers with income below certain thresholds may contribute to a Roth IRA. In 2024, contributions are phased out between MAGI of $230,000–$240,000 for MFJ, $146,000–$161,000 for Single, and $0–$10,000 for Married Filing Separately ("MFS").
- There are no age restrictions on contributions to a Roth IRA.
- For 2024, the nondeductible contribution can be up to $7,000 per individual. Individuals age 50 or older can make an additional "catch-up contribution" of $1,000.
- Contributions cannot exceed earned income.
- The contribution due date is generally the tax filing deadline of April 15.

What other important facts should I know?

- Loans are not permitted.
- Joint accounts are not permitted.
- Prohibited investments include life insurance and antiques/collectibles.
- Excess contributions result in a penalty of 6% excise tax each year the excess amount is not withdrawn.
- For a non-qualified distribution, the first part will be a return of the original contribution, followed by any funds that may have resulted from a Roth IRA conversion, and earnings being withdrawn last.
- RMD rules do not apply to Roth IRAs during the original owner's life.

- Know the specific rules of different types of Roth IRA distributions.
    - Roth IRAs held for at least five years:
        - A qualified distribution is tax-free, must be made after holding the account for at least five years, and:
            - after the owner turns age 59 ½,
            - upon the owner's death,
            - attributable to the owner becoming disabled, or
            - for a first-time home purchase (lifetime cap of $10,000).
        - Distributions taken before age 59 ½ where investment earnings are taxable, but not subject to a 10% early withdrawal penalty, must be made after holding the account for at least five years, and be for:
            - higher education expenses,
            - unreimbursed medical expenses in excess of 7.5% of AGI,
            - medical insurance premiums while unemployed, or
            - substantially equal periodic payments.
        - All other distributions taken before age 59 ½ result in a 10% early withdrawal penalty plus a tax on investment earnings, even if the account is held for at least five years.

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    - Roth IRAs held less than five years:
        - Distributions taken before holding the account for at least five years where investment earnings are taxable, but not subject to a 10% early withdrawal penalty, can be taken:
            - after the owner turns age 59 ½,
            - upon the owner's death,
            - if the owner becomes disabled,
            - for a first-time home purchase (lifetime cap of $10,000),
            - for higher education expenses,
            - for unreimbursed medical expenses in excess of 7.5% of AGI,
            - for medical insurance premiums while unemployed, or
            - for substantially equal periodic payments.
        - All other distributions taken before age 59 ½ and before holding the account for at least five years will result in a 10% early withdrawal penalty plus a tax on investment earnings.

What is it?

- An Inherited IRA is opened when an individual inherits an IRA or company-sponsored retirement plan upon the original owner's death. Rules on the inheritance of this account differ between spouses and non-spouses.

What important facts should I know?

- Inherited Traditional IRA:
  - Withdrawals from an Inherited Traditional IRA generally are taxable as regular income at the beneficiary's current income tax rate.
  - Options for spouses who inherit a Traditional IRA:
    - A spousal beneficiary is considered to be an eligible designated beneficiary, along with disabled or chronically ill individuals, individuals not more than 10 years younger than the original IRA owner, and children of the original IRA owner who have not reached majority age.
    - A spouse may roll over the assets from the original owner's Traditional IRA or company-sponsored retirement plan to his or her own Traditional IRA and defer RMDs until age 73.
    - Spousal beneficiaries can also establish an Inherited IRA account:
      - If the original owner of a Traditional IRA was already receiving RMDs at the time of death, the spousal beneficiary must continue taking distributions as calculated. Alternatively, the spousal beneficiary can submit a revised schedule based on his or her own life expectancy.
      - If the original owner of a Traditional IRA was not already receiving RMDs at the time of death, the spousal beneficiary must withdraw all of the funds within five years of the original owner passing away.

- Options for non-spouses who inherit a Traditional IRA:
  - Non-spouse designated beneficiaries may not make additional contributions to the account, transfer funds into an existing IRA account in their own names, may not leave assets in the original Traditional IRA, and must set up a new Traditional Inherited IRA account unless they want to distribute the assets immediately via one lump-sum payment.
  - Non-spouse designated beneficiaries may take distributions over time, as long as the Traditional IRA funds are completely withdrawn within 10 years of the original owner passing away.
  - Some non-spouse beneficiaries are exempt, including disabled or chronically ill individuals, individuals not more than 10 years younger than the original IRA owner, and children of the original IRA owner who have not reached majority age.

- Inherited Roth IRA:
  - Unlike the original Roth IRA owner, an Inherited Roth IRA beneficiary must take RMDs from the account.
  - Options for spouses who inherit a Roth IRA:
    - Spousal beneficiaries may transfer the assets from the original owner's Roth IRA to their own Roth IRA. The spouse will be subject to the same distribution rules as the original owner and are not taxed if the five-year Roth IRA rule has been met.
    - Open an Inherited Roth IRA under the "life expectancy" method, where the spouse must take RMDs stretched over his or her life expectancy. Distributions are not taxed if the five-year Roth IRA rule has been met.
    - Open an Inherited Roth IRA under the "five-year" method, where the spouse can receive distributions in increments over time, but the Inherited Roth IRA account must be fully distributed by December 31 of the fifth year after the original owner passed away. Distributions are not taxed if the five-year Roth IRA rule has been met.
    - Take one lump-sum distribution. Distributions are not taxed if the five-year Roth IRA rule has been met.
  - Options for non-spouses who inherit a Roth IRA:
    - Non-spouse beneficiaries typically must withdrawal all assets from the account within 10 years of the original owner passing away. Distributions are not taxed if the five-year Roth IRA rule has been met.
    - Some beneficiaries are exempt, including disabled or chronically ill individuals, individuals not more than 10 years younger than the original IRA owner, and children of the original IRA owner who have not reached majority age.

SEP IRA

What is it?

- An employer-sponsored individual retirement account where all contributions are solely made by the employer. No employees may defer their income.
- Employer contributions are discretionary.
- Combines simplicity of design with a high degree of flexibility from the employer's perspective.
- The limits for employee contributions are the lesser of 25% of compensation (covered compensation is limited to $345,000), or $69,000 in 2024. If self-employed, your contributions are generally limited to 20% of net income.

Who is it meant for?

- A small-business employer seeking to make discretionary contributions and an alternative to a qualified profit-sharing plan that is easier and less expensive to install and administer.
- May be established by C corporations, S corporations, Partnerships, LLCs, and Sole Proprietorships.
- A SEP plan must cover all employees who are at least age 21 and who have worked for the employer during three of the preceding five calendar years. Part-time employment counts in determining service.
- The monetary benefits of a SEP plan are totally portable by employees because funding consists entirely of IRAs for each employee.

What other important facts should I know?

- Loans are not permitted.
- Joint accounts are not permitted, and each participating employee maintains an IRA.
- Prohibited investments include life insurance and antiques/collectibles.
- Employer contributions are always fully vested and are not forfeitable.
- An employer may deduct contributions to a SEP plan up to the contribution limit.
- If an employer maintains a SEP plan and also maintains a regular qualified plan, contributions to the SEP plan reduce the amount that can be deducted for contributions to the regular plan.
- Distributions to employees from the plan are treated as distributions from an IRA.
- Investments are limited to investments permitted in an IRA (no collectibles and no life insurance).
- A 10% excise tax is assessed on excess employer contributions.
- Participation in a SEP plan counts as active participant status for purposes of determining the deductibility of separate traditional IRA contributions.

SIMPLE IRA

What is it?

- A savings incentive match plan for employees (SIMPLE).
- SIMPLE IRAs allow employees to make elective contributions as a percentage of compensation up to $16,000 (2024).
- In addition, individuals who have attained age 50 may make additional catch-up contributions. The additional catch-up amount is $3,500 (2024).

Who is it meant for?

- Employers with 100 or fewer employees who earned at least $5,000 during the preceding year and who do not maintain another employer-sponsored retirement plan (there is a two-year grace period to continue to maintain plan when number of employees exceeds 100) are eligible.
- Employees who earned $5,000 during any two preceding years and are reasonably expected to receive at least $5,000 during the current year are eligible participants.
- A self-employed person can establish a SIMPLE.

What other important facts should I know?

- Loans are not permitted.
- Joint accounts are not permitted.
- Prohibited investments include life insurance and antiques/collectibles.
- Employers cannot maintain another qualified plan, SEP, or 403(b) plan, but qualified employers can maintain a 457 plan and also have a SIMPLE.
- The prohibited investment rules for individual retirement accounts also apply to SIMPLE IRAs and SEP plans.

- SIMPLE IRAs are not subject to nondiscrimination rules generally applicable to qualified plans.
- Employers must make contributions to the SIMPLE based on one of the following options:
    - Match dollar for dollar up to 3% of employee’s compensation.
    - Make a 2% of compensation nonelective contribution for each eligible employee.
- All contributions are immediately and fully vested to the employee.
- No more than $345,000 (2024) compensation can be taken into account for purposes of the 2% nonelective contribution.

- After-tax contributions are not allowed.
- Contributions made by employees are excludable from the employee's gross income for income tax purposes and are subject to payroll taxes.
- Because a SIMPLE IRA is a form of IRA, it may not purchase life insurance as a funding vehicle.
- Contributions by the employer are deductible if made by the due date of tax return (including extensions. Employer contributions are not subject to payroll tax.
- Contributions made by employees are excludable from the employee's gross income for income tax purposes. Employee contributions are subject to payroll tax.
- SIMPLE IRA withdrawals made within two years of initial participation are subject to a 25% premature distribution penalty tax (rather than 10%). a. However, certain exceptions to the penalty apply under IRC Section 72(t). After the first two years, the early withdrawal penalty for a SIMPLE IRA reverts to a 10% penalty.
- Distributions from a SIMPLE may be rolled over to another SIMPLE, but may not be rolled over to any other type of plan during the first two years of participation. Other plans, except Roth accounts, may not be rolled over to SIMPLEs until the participant's first two years have passed.

IRA Rollover

What is an IRA Rollover, and what important facts should I know?

- An IRA rollover allows for the transfer of assets from an employer-sponsored retirement account to a Traditional IRA, maintaining the tax-deferred status of those assets until withdrawn. IRA rollovers are reported on tax returns as non-taxable transactions.
- Eligible rollover distributions must be either transferred to the IRA via a direct transfer or rollover by the participant.
  - A direct transfer is an eligible rollover distribution that is paid directly to a rollover IRA for the benefit of the participant and is not subject to a mandatory withholding of 20%.
  - If a distribution is received by the participant and the tax on the distribution is to be deferred, the rollover must be made within 60 days of receipt of the distribution and follows IRS rules. Any taxable eligible rollover distribution paid from an employer-sponsored retirement plan is subject to a mandatory income tax withholding of 20% even if the participant intends to roll it over later. If the distribution is subsequently rolled over, the participant must add funds from other sources equal to the amount withheld or the withheld amount itself is subject to current taxation and a possible early withdrawal penalty.
- Only one rollover from an IRA to another (or the same) IRA in any 12-month period is permitted, regardless of the number of IRAs owned by the participant. Trustee-to-trustee direct transfers between IRAs are not limited.
- Rollovers from traditional IRAs to Roth IRAs (conversions) are also not limited.

What kind of company plans can I rollover into my own Traditional IRA?

- Qualified Retirement Plans (i.e. 401k, 403b, Profit-Sharing Plans).
- Tax-Sheltered Annuities (“TSAs”).
- 457 Plans (not nongovernmental).
- SIMPLE IRA (after two years of participation).

When can I roll over my assets into a Traditional IRA if I decide I want to do so?

- Assets can be rolled over from an old company-sponsored plan after employment has ceased at that company.
- If an individual is over the age of 59 ½, there is a good chance he or she can roll over assets into a Traditional IRA, even while still employed at the company. In addition, the individual can still contribute to the company sponsored plan and receive all the same benefits. Be sure to check with your employer and/or retirement benefits administrator to ask if they allow “In-Service Rollovers”.

What are some pros and cons of rolling over my assets vs. leaving them as-is?

- An individual may consider rolling over his or her assets to a Traditional IRA for reasons that can include the following:
  - The individual is dissatisfied with the company plan's investment performance and fee structure.
  - Investment selections in the company plan are limited, and the individual wants access to more options so that he or she can create a personalized investment strategy.
  - The individual wants quicker and simpler access to his or her funds without having to go through the company.
  - Funds rolled over from a qualified company plan to a Traditional IRA are still protected from creditors in accordance with the Employee Retirement Income Security Act of 1974 ("ERISA").
- An individual may consider forgoing the rollover of his or her assets to a Traditional IRA for reasons that can include the following:
  - The individual's company plan has an inexpensive fee structure with broad investment options.
  - The individual already receives ongoing fiduciary financial planning, education, update calls, and personalized advice from the company plan advisor.

Roth IRA Conversion

What is a Roth IRA conversion?

- A Roth IRA conversion (aka "Back-Door Roth") involves transferring retirement funds from a Traditional IRA or qualified company plan (i.e. 401k, Profit-Sharing Plan) into a Roth IRA.
- Any deferred income taxes due must be paid on the converted funds at that time.
- Assets held in a Traditional IRA or qualified company plan may be converted to a Roth IRA regardless of a taxpayer's MAGI.
- Any amount converted that is a return of basis is not included in income.
- The 10% early withdrawal penalty does not apply.

What are some pros and cons of converting my pre-tax assets to a Roth IRA?

- Pros can include the following:
    - Contributions and earnings grow tax-free.
    - There are no RMD requirements.
    - Beneficiaries can withdraw funds tax-free assuming the five-year rule is met.
    - Those normally ineligible for a Roth IRA can use a conversion to create a Roth IRA and have tax-free growth.
    - It can be beneficial if tax rates are expected to increase in the future.
- Cons can include the following:
    - Taxes are paid on the conversion when it occurs, which can be substantial.
    - An individual must wait at least five years to take a tax-free withdrawal from the Roth IRA, even if he or she is age 59 ½ or older.
    - If taxes are higher now than they will be in the future, an individual may not benefit from a conversion.