Tax Tips You Can Use August 2009

IRA distributions

By Kathleen Crawford, EA

Last month's article described a strategy to move stock gain from a traditional IRA account to a tax free Roth IRA account. This month's article adds a twist to that strategy and gives basic considerations of IRA distributions. Taxpayers over the age of 59 & ½ can take IRA distributions without penalty. Those distributions are considered ordinary income like wages.

Those who read last month's article know that I had purchased Apple, Inc stock for my traditional IRA. Noticing that it had dropped in value, but believing that it would recover, I moved it into my Roth IRA. That distribution required that I pay tax on the (depressed) value at the time of the move. I have watched it recover and will take the gain tax free with my future qualified Roth distributions. Had I been over 59 & 1/2, I could have moved the stock, at its depressed value, into a regular investment account where I keep personal savings. I would have had to pay tax on the distribution at the depressed value. Any gains from the recovery would be taxed at capital gain rates when I sold the stock. As of today, the long term capital gains tax rates are lower than ordinary rates. The capital gains rates are currently 0% (yes, zero) or 15% for higher income taxpayers.

To summarize this strategy, instead of letting my stock recover in the IRA and paying ordinary rates on all of the value, I opt to take a distribution at the depressed value and later pay capital gains tax on the recovery gains. That can lower total income tax if capital gains rates remain favorable.

I am surprised by the number of people who seem to believe that they cannot take money out of their retirement accounts. I don't know where the fear comes from, but it is as if the money will evaporate somehow. The truth is that savings can be pre-tax or already-taxed. Moving money from the pre-tax IRA savings to the already-taxed savings accounts will happen at the taxpayers discretion or will be mandated by the IRS after the taxpayer reaches 70 & 1/2. Taxpayers, particularly those in their 60's, should review their situation to move their money from IRA funds to already-taxed savings in the most tax advantaged method. Taxpayers with social security and stable pensions will have few options to save tax. However, with planning, some taxpayers can save substantial tax. One client bought a new business and had a big loss that first year. He moved his six figure IRA to already-taxes savings, but paid no income tax on the distribution because his loss offset the income. Had he waited to 70 & ½, his required IRA distributions would be added on top of his now-successful-business income and he would have paid tax on his IRA funds at the maximum rate.

Although many of us do not want to look at our retirement account statements, it is important to strategize the best way to manage whatever we have.

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The fine print is that this article is for information only. Please call Kathy or a tax professional for questions about your individual tax situation. The Jacksonville Tax Lady can be reached at 541-899-7926 or at 610 North Fifth Street.