PacificCPE

COURSE
30905C

Financial Planning: IRAs and Social Security Tax

Individual retirement arrangements and Social Security benefits are central to retirement income planning for most clients. This course covers traditional IRAs, Roth conversions, distribution rules, and the penalties that apply when prohibited transactions occur. It then shifts to Social Security, explaining how the system works and—critically—how benefits are taxed at the federal level. Professionals advising clients approaching retirement or already drawing income from these sources will find this course directly relevant to the planning conversations happening in their practices right now.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify the different tax rules and implications as they apply to the different types of individual retirement arrangements (IRAs).
- Recognize the rules governing the benefits provided through the social security system.

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Chapter 1: INDIVIDUAL RETIREMENT ARRANGEMENTS (IRAs)

Chapter Objective

After completing this chapter, you should be able to:

- Identify the different tax rules and implications as they apply to the different types of individual retirement arrangements (IRAs).

An individual retirement arrangement (IRA) is a personal savings plan that gives individual taxpayers tax advantages for setting aside money for retirement. Two tax advantages of an IRA are that:

- Contributions made to an IRA may be fully or partially deductible, depending on the type of IRA and the taxpayers individual circumstances; and
- Generally, amounts in a taxpayer's IRA (including earnings and gains) are not taxed until distributed. In some cases, amounts are not taxed at all if distributed according to the rules.

I. TRADITIONAL IRA

This section discusses the original IRA. In this chapter the original IRA (sometimes called an ordinary or regular IRA) is referred to as a "traditional IRA."

A. ELIGIBILITY REQUIREMENTS

An individual can set up and make contributions to a traditional IRA if:

- The individual (or, if he or she files a joint return, his or her spouse) received taxable compensation during the year.

Individuals can have a traditional IRA whether or not they are covered by any other retirement plan. However, individuals may not be able to deduct all of their contributions if they or their spouse is covered by an employer retirement plan.

Note

For tax years beginning after December 31, 2019, the rule that you are not able to make contributions to your traditional IRA for the year in which you reach age 70½ and all later years has been repealed.

TABLE 12-1. HOW ARE A TRADITIONAL IRA AND A ROTH IRA DIFFERENT?

This table shows the differences between traditional and Roth IRAs. Answers in the middle column apply to traditional IRAs. Answers in the right column apply to Roth IRAs.

Question	Traditional IRA	Roth IRA
Age limits to set up and contribute to an IRA	After 2019, can be established and contributed to at any age	Can be established at any age
Earnings and contribution limits	No upper limit on how much a taxpayer can earn and still contribute; contribution limits determined annually	Some limits based on income, filing status and whether taxpayer contributes to another IRA
Deductibility of contributions	Taxpayers may be able to deduct contributions to IRA depending on income, filing status, and whether they are covered by a retirement plan at work or receive social security benefits	Contributions to Roth IRA are never deductible
Filing requirement for contributions	No filing required unless taxpayer made nondeductible contributions to traditional IRA (in which case Form 8606 must be filed)	No filing required for contributions to Roth IRA
Mandatory distributions	Taxpayers must begin receiving required minimum distributions by April 1 of the year following the year they reach age 73	Owners of Rothe IRA not required to take distributions regardless of age
Taxation of distributions	Distributions from a traditional IRA are taxed as ordinary income, but if taxpayer made	Distributions from Roth IRA are not taxed as long as the owner meets certain criteria

	nondeductible contributions, not all of the distribution is taxable	
Reporting of distributions	No reporting requirements unless taxpayers ever made nondeductible contributions to traditional IRA (then must file Form 8606)	Owners must file Form 8606 if they receive distributions from a Roth IRA (other than a rollover, qualified charitable contribution, one- time distribution to fund an HSA, recharacterization, certain qualified distributions, or a return of certain contributions)

If both the individual and his or her spouse have compensation, each can set up an IRA, but cannot both participate in the same IRA.

B. COMPENSATION

Generally, compensation is what an individual earns from working, i.e., wages, salaries, tips, professional fees and other amounts received for providing services. For self-employed individuals, compensation is the net earnings from the person's trade or business (provided their personal services are a material income-producing factor) reduced by the total of:

- The deduction for contributions made on the individual's behalf to retirement plans; and
- The deduction allowed for one-half of self-employment taxes.

When an individual has both self-employment income and salaries and wages, his or her compensation includes both amounts. If an individual has a net loss from self-employment, he or she may not subtract the loss from his or her salaries or wages when figuring his or her total compensation.

1. Alimony and Separate Maintenance

For IRA purposes, compensation includes any taxable alimony and separate maintenance payments received under a decree of divorce or separate maintenance.

Note

Taxable alimony only relates to a decree of divorce or separation instrument executed on or before December 31, 2018, that has not been modified to exclude such amounts.

TABLE 12-2. COMPENSATION FOR PURPOSES OF AN IRA

- Nontaxable combat pay
- Taxable non-tuition fellowship and stipend payments

Compensation Includes:	Compensation Does Not Include:
• Wages, salaries, etc.	• Earnings and profits from property
• Commissions	• Interest and dividend income
• Self-employment income	• Pension or annuity income
• Taxable alimony and separate maintenance	• Deferred compensation
(instruments executed before December 31,	• Income from certain partnerships
2018)	• Any amounts excluded from income

C. TYPES OF TRADITIONAL INDIVIDUAL RETIREMENT ARRANGEMENTS

A traditional IRA can be an individual retirement account or annuity. It can be part of either a simplified employee pension (SEP) or an employer or employee association trust account.

1. Individual Retirement Account

An individual retirement account is a trust or custodial account set up in the United States for the exclusive benefit of one person or his or her beneficiaries. The account is created by a written document. The document must show that the account meets all of the following requirements:

- The trustee or custodian must be a bank, a federally insured credit union, a savings and loan association, or an entity approved by the IRS to act as trustee or custodian;
- The trustee or custodian generally cannot accept contributions of more than the deductible amount for the year. However, rollover contributions and

employer contributions to a simplified employee pension (SEP), can be more than this amount;

- Contributions, except for rollover contributions, must be in cash;
- The investor must have a nonforfeitable right to the amount at all times;
- Money in the account cannot be used to buy a life insurance policy;
- Assets in the account cannot be combined with other property, except in a common trust fund or common investment fund; and
- The individual must start receiving distributions by April 1 of the year following the year in which he or she reaches age 73.

2. Individual Retirement Annuity

A person can open an individual retirement annuity by purchasing an annuity contract or an endowment contract from a life insurance company. An individual retirement annuity must be issued in the investor's name as the owner, and either the owner or his or her beneficiaries who survive are the only ones who can receive the benefits or payments.

An individual retirement annuity must meet all of the following requirements:

- The investor's entire interest in the contract must be nonforfeitable;
- The contract must provide that the investor cannot transfer any portion of it to any person other than the issuer;
- There must be flexible premiums so that if the investor's compensation changes, his or her payment can also change. This provision applies to contracts issued after November 6, 1978;
- The contract must provide that contributions cannot be more than the deductible amount for an IRA for the year, and that the investor must use any refunded premiums to pay for future premiums or to buy more benefits before the end of the calendar year after the year in which he or she receives the refund; and
- Distributions must begin by April 1 of the year following the year in which the investor reaches age 73.

3. Individual Retirement Bonds

The sale of individual retirement bonds issued by the federal government was suspended after April 30, 1982.

4. Simplified Employee Pension (SEP)

A simplified employee pension (SEP) is a written arrangement that allows an investor's employer to make deductible contributions to a traditional IRA (a SEP-IRA) set up for the employee to receive such contributions. Generally, distributions from SEP IRAs are subject to the withdrawal and tax rules that apply to traditional IRAs.

D. CONTRIBUTION LIMITS

There are limits and other rules that affect the amount that can be contributed to a traditional IRA. The following are some rules to keep in mind:

- Except as discussed below under Kay Bailey Hutchison Spousal IRA Limit, each spouse figures his or her limit separately, using his or her own compensation. This is the rule even in states with community property laws;
- Brokers' commissions paid in connection with a traditional IRA are subject to the contribution limit;
- Trustees' administrative fees are not subject to the contribution limit; and
- Contributions on an individual's behalf to a traditional IRA reduces his or her limit for contributions to a Roth IRA.

1. General Limit

The most that can be contributed to a traditional IRA is the smaller of the following amounts:

- $7,500 ($8,600 if you are 50 or older) in 2026 ($7,000 and $8,000, respectively, for 2025); or
- The individual's taxable compensation (defined above) for the year.

This is the most that can be contributed regardless of whether the contributions are to one or more traditional IRAs or whether all or part of the contributions are nondeductible.

Examples

George, who is 34 years old and single, earns $24,000 in 2026. His IRA contributions for 2026 are limited to $7,500.

Danny, an unmarried college student working part time, earns $3,500 in 2026. His IRA contributions for 2026 are limited to $3,500, the amount of his compensation.

2. More Than One IRA