CPA Practice Advisor

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One of the issues that often causes a high degree of client confusion is whether or not a withdrawal from their IRA account will be taxable, and if so, to what extent.

While I'm sure all of you reading this piece know the rules backward and forward, it might be helpful to lay them out so that as various client situations arise, you can easily explain them to your clients.

Traditional IRAs

Withdrawals from a traditional IRA account are fully taxable if all of the money

If your client is younger than 59 ½ years old, their traditional IRA withdrawals may be subject to a 10 percent penalty in addition to the tax due if they take a distribution. There are some exceptions to the penalty and they include:

- If the withdrawal is made to cover eligible college expenses.
- A penalty-free withdrawal of up to $10,000 (up to $20,000 for a married couple) can be taken to buy, build or rebuild the client's first home or that of qualified family members.
- Unreimbursed medical expenses that exceed 10 percent of adjusted gross income can be taken penalty-free.
- IRA distributions taken to cover the cost of health insurance for clients, their spouse and their dependents following a period of unemployment will not incur the 10 percent penalty.
- Distributions taken in connection with a disability can be exempt from the penalty, but clients will need to be able to prove that they are truly disabled.
- Leaving an IRA to an heir if the client dies prior to age 59 ½ allows the heir to take distributions without incurring the penalty. However, if the heir is a spouse and he or she takes the IRA as their own and makes subsequent withdrawal prior to age 59 ½, then the distribution would be subject to the penalty.
- Clients can set up a series of payments from their account if they are under age 59 ½, and if the rules are followed, this series of distributions are not subject to the penalty. This falls under the 72(t) rules and they are complex. Some custodians do not fully understand them, so if a client wants to go this route they will need your expert guidance.
- Members of the military who are on active duty, subject to the appropriate rules, can take penalty-free withdrawals.
- Withdrawals from an IRA to cover the payment of an IRS tax levy are not subject to the penalty.

IRA Account Transfers

transfer. This leaves a full paper trail and avoids inadvertent mistakes that can cause them to miss the 60-day window.

Roth IRAs

Roth IRA withdrawals are not taxable as long as the initial Roth contribution was made at least five years ago and your client is at least 59 ½ years old. For purposes of the five-year rule, all Roth IRA accounts of the account holder are included. So-called qualified Roth distributions also include:

- Disability
- A beneficiary receiving the account proceeds as a result of the account holder’s death.
- The distribution is $10,000 or less and will be used for the purchase of or rebuilding of the account holder’s first home or that of qualified family members.

Taxation of non-qualified Roth withdrawals can be subject to both income taxes and a 10 percent penalty, but this calculation is subject to the complex ordering rules that are applied for Roth IRA distributions. If a client is considering a distribution from their Roth IRA, they would benefit from your guidance prior to taking this distribution.

In Conclusion

Your clients may be confused about whether an IRA withdrawal will be taxed, and if so, how much tax will apply. This area is complex and your clients can benefit from your expertise to help them avoid costly mistakes.

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