

# IRA DISTRIBUTION BASICS – TAXATION OF DISTRIBUTIONS



By Greg Koch, Koch Insurance Brokers LLC, Koch Financial Group LLC

Most IRA accounts hold pre-tax contributions and rollover amounts from employer plans. For purposes of this article, I am going to assume that there are no after-tax amounts held in any IRA, including SEP and SIMPLE IRAs.

IRA distributions where the check is made payable to the IRA owner or the funds are transferred to a non-IRA account are almost *always* taxable. There are, of course, exceptions. If some or all of the distribution is rolled over within 60 days to another retirement account and no other rollovers were done in the prior 12 months, there is no tax on the rolled over amount. If the IRA owner or beneficiary, who is 70 ½ or older, does a qualified charitable distribution (which is actually a transfer, not a distribution), there is no tax. If you take a distribution to correct an excess or unwanted IRA contribution by the deadline, only the net income attributable would be taxable, not the contribution amount.

**All other IRA distributions are taxable.** There is no exception to the income tax due for economic hardship, not even for extreme economic hardship. There is no

exception to the income tax due for reasons of disability.

In the case of a divorce, IRA funds can be transferred to an ex-spouse, but only when this is directed by the divorce decree or separation agreement and after it has been approved by a court. The IRA owner who takes a distribution of IRA funds and then turns them over to the ex-spouse will have a taxable distribution. The ex-spouse will not have an IRA.

A distribution from the IRA to pay income taxes is itself taxable. If you owe the IRS \$10,000 and take a distribution from your IRA to pay the IRS, you have satisfied the \$10,000 bill but you have also added \$10,000 to your income for the current year.

Using IRA funds for an alternative investment has tripped up a lot of taxpayers over the years. In order to invest in real estate, master limited partnerships, other hard-to-value assets, gold, or anything other than publicly traded stocks, bonds, and mutual funds, the IRA must purchase the asset. The IRA owner cannot take a distribution from the IRA, use the funds to purchase an asset, and then put that asset into an IRA. Simply titling an asset in the name of the IRA is not enough to make an asset an IRA asset. The entire purchase process, from start to finish must be done in the name of the IRA and be between the IRA (and the IRA custodian) and the “seller.” Be wary of promoters who assure you that their asset can be held in an IRA and tell you to just send the money. IRA assets must be held by an IRA custodian.

When the IRA custodian issues a 1099-R showing a distribution from an IRA, don't ignore it, even if you are 100% sure that your transaction is not taxable. Not including a 1099-R on a tax return is a sure invitation to a polite request from IRS to pay any taxes owed.

For additional information, please call Greg Koch at 610.370.7268; or email Greg@KochInsBrokers.com.



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