Monthly IRA Updates

ED SLOTT AND COMPANY, LLC
America's IRA Experts

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?? **Question of the Month: Can a Non-Working Spouse Contribute to a Roth IRA?**

Q: Can the spouse of a self-employed earner contribute to a Roth IRA? I would like to contribute, but the information I have read is unclear on the subject.

A: A non-working spouse can contribute to a Roth IRA so long as the working spouse has enough earned income. There are, however, earned income phase-out limits for contributions to Roth IRAs. If you are filing a joint tax return the phase-out starts at $169,000 and completely phases-out at $179,000. If you are filing married-separate your phase-out range is $0 to $10,000.

The Roth contribution can be made up to the tax filing date. There is no extension beyond that date, regardless of whether an extension is filed for the income tax return. The contribution limit for 2011 is $5,000. However, if you are age 50 or older by 12/31/2011 you can add a catch up contribution of up to $1,000 for a total of $6,000.

Court Ruling: Taxpayer is Ineligible for IRA Deduction

The May issue of *Ed Slott's IRA Advisor Newsletter* goes through the court case, Robert Kobell v. Commissioner (T.C. Memo 2011-66; March 17, 2011), in which it was determined that a taxpayer did not qualify to be treated as a professional trader.

The aftermath of the ruling resulted in the income from his investments not being treated as compensation, making him ineligible to receive a deduction for his IRA contribution because he had no other earned income for the year.

FIND OUT THE DETAILS OF THE COURT CASE IN ED SLOTT'S IRA ADVISOR NEWSLETTER

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Inside Ed Slott's IRA Advisor Newsletter

Court Rules that Taxpayer Has No Compensation and is Ineligible for an IRA Deduction

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- Professional Trader Status
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  - From *IRS Publication 525:* Taxable and Nontaxable Income
  - IRS Prop. Reg. §1.219(a)-1(b)(3)
- IRA Contribution Q & A

Chart: What is Compensation for IRA and Roth IRA Contribution Eligibility

Guest IRA Expert

Seymour Goldberg
CPA, MBA, JD
Goldberg & Goldberg, P.C.
Woodbury, NY

IRA Legal Update

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May Key Focus

Making Retirement Contributions For a Deceased Individual

Making a retirement contribution for a deceased individual... this is an interesting situation that comes up more often than you may think. A taxpayer dies. He or she had earned income during the year before death. The tax preparer or estate administrator suggests making an IRA contribution to reduce the income tax on the final return.

It sounds logical that you should be able to do this. After all, he or she had earned income. And maybe he or she even made their annual contributions at the end of the year; they just didn't live long enough to do it this year.

IRS was asked to rule on this issue in 1984 (Private Letter Ruling 84390066). It stated that a contribution made after the death of the account owner "would not be a contribution for retirement purposes." In other words, you cannot make a retirement contribution after you are dead because you no longer need a retirement plan. It is hard to argue with that logic.

IRS also ruled that a contribution made to a deceased individual's account after his death would be treated as an excess contribution. An excess contribution is subject to a penalty of 6% for every year that it remains in the account. To avoid the penalty, you must tell the IRA custodian that you are removing an excess contribution (this way they code the 1099-R correctly and you are not taxed twice on the same money). The funds, plus any earned income or losses deducted, must be removed by October 15th of the year after the year for which they are contributed.

In a later ruling, (PLR 8527083), IRS allowed for a contribution to a non-working surviving spouse's IRA made after the death of the working spouse. After all, the surviving spouse will still need a retirement account.

Ruling to Remember

Tax Court Memo 2011-62

The Christy & Swan Profit Sharing Plan was established in 1976 by a real estate business. The owner was the sole participant, and he served as plan trustee. Ten years later, the plan was deemed to be a qualified tax-exempt plan by the IRS under Code Sec. 401(a). However, a mistake was made when the plan wasn't amended to comply with the new tax law changes.

In 2006, the plan filed its Form 5500-EZ, titled "Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan)" for its 2005 plan year. In June 2007, IRS started an audit of the plan with an examination of that form. Two months later, the plan trustee (i.e. the business owner) signed and provided IRS with a declaration stating that the plan was "amended" by general reference to incorporate all of the changes necessary to retain status under Code Sec. 401(a). IRS disagreed.

The plan trustee refused to participate in the closing agreement program and argued that the plan had ceased to exist because there had been no contributions or new participants since 2000.

In July 2009, IRS sent the plan trustee a letter stating the plan was disqualified because it had not been amended, regardless of whether the plan still permitted contributions or admissions of new particpants, and sent him a final revocation letter.

Finally, the Tax Court ruled, affirming IRS' revocation of the plan's tax-exempt status.

LESSON TO LEARN:
The main point to take away from this case is that the company owner did not cooperate with IRS, which wants plans to succeed and provide benefits for covered employees. IRS, in fact, has set up a self correction process to help small business owners correct violations in their plans [www.irs.gov]. Instead, the plan trustee took the opposite approach. Because the plan lost its tax-exempt status, the plan participants (in this case one person) will owe income tax on any plan distributions and they will no longer have a retirement plan.