There's no questioning value of new IRAs

What major changes did the Economic Recovery Tax Act of 1981 make in IRAs and Keogh plans?

Most importantly, the Individual Retirement Account program was greatly expanded to cover everyone who works for a living whether they have pension or retirement plans at work or not. This is the so-called "universal IRA," which will make these retirement savings plans available to a vast new market. Formerly, only people who were not active participants in pension or retirement plans at work were allowed to have IRAs.

In addition, the new law increases the annual dollar limits on contributions to both IRAs and Keogh plans, which are for the self-employed. And it eliminates the percentage of income restriction that formerly applied to IRA contributions.

What are the new IRA contribution limits?

The new limits are $2,000 or 100 percent of compensation, whichever is less, for individuals. In effect this means anyone who earned $2,000 or more can contribute up to $2,000. Working couples who file jointly can now contribute up to $2,000 each, or a total of $4,000, but their IRAs must be separately maintained.

Contribution limits for so-called "spousal IRAs," where only one spouse works during the year, were increased to $2,250 or 100 percent of compensation, whichever is less.

What are the new Keogh annual contribution limits?

Up to $15,000 or 15 percent of self-employment income, whichever is less.

When do these changes take effect?

For taxable years after Dec. 31, 1981.

What are the benefits of an IRA or Keogh plan?

To begin with, contributions are sheltered from taxation. If you contribute $2,000 to an IRA or Keogh plan in 1982 and are in a 26-percent bracket, this reduces your income tax bill for 1982 by 26 percent of $2,000, which is $520.

Equally important, the money your IRA or Keogh plan continues to earn over the year is also sheltered from taxation until you begin withdrawing it.

What kinds of IRA and Keogh investments can people make?

Savings accounts and certificates at savings and loan associations and other depository institutions, mutual funds; so-called "self-directed" plans buying and selling stocks, bonds or anything else not specifically barred by law; insurance annuities or endowment contracts, and individual retirement bonds, which are special bonds issued by the federal government.

What IRA and Keogh investments are specifically barred by law?

The new tax law, which went in effect Jan. 1, bars IRA and Keogh investments in self-direct plans that buy collectibles, such as any work of art, rug, antique, metal, gem, stamp, coin, alcoholic beverage or other item of tangible personal property. Any such investments made after that date will be considered distributions from the plan in the tax year in which the investments are made.

How long must people keep money in IRAs or Keogh plans?

Unless you are permenently disabled, the IRS will penalize you for making any withdrawals before you are age 59½. The amount withdrawn must be included in your ordinary income for that year. In addition, you must pay a 10-percent premature distribution tax on the amount withdrawn.

Can people with Keogh plans have IRAs, and can people with IRAs have Keogh plans?

Yes. Self-employment income qualifies for both types of plans. If you earned $100,000 from self-employment, you could contribute the maximum $15,000 ($100,000 x 15 percent) to a Keogh plan. Because you had earned more than $2,000, you could also contribute $2,000 to an IRA, for a tax-sheltered total of $17,000 that year.

Does money contributed to an IRA or Keogh plan have to come directly from compensation? Or can it come from savings or other investment sources?

Although the contribution must be based on elgible compensation, the actual dollar put in can come from any source, provided you don't borrow it, and then deduct the interest on your tax return. Interest on loans to make any tax-sheltered investment, including IRA and Keogh contributions, is not deductible.

When are taxes paid on money sheltered in IRAs and Keogh plans?

When money is withdrawn, it is taxed as ordinary income in the year withdrawn. If it is withdrawn in a lump sum, you may find it to yor advantage to use the five-year income-averaging rule. If it is withdrawn in installments, often you will be in a lower tax bracket than when you earned it.

What happens if I die before all the money in my IRA or Keogh plan is withdrawn?

The money that remains goes to your designated beneficiary or beneficiaries and will be taxed when withdrawn. However, beneficiaries have a number of options, and these should be discussed with a tax adviser.

How long can I continue contributing to an IRA or Keogh plan?

Until the year in which you reach age 70½, at which time you are required to begin withdrawing it, either all in a lump sum or on a regular schedule.

Between ages 59½ and 70½, can I continue contributing to an IRA plan even though I may also be making withdrawals from it?

Yes, provided you are earning compensation that qualifies for the contributions.

INDIVIDUAL RETIREMENT ACCOUNTS

How much time do people have left to open an IRA and shelter 1982 income from taxation?

Until April 15, 1983, or the date when they file their 1982 tax return.

How many IRAs can a person have?

As many as you like, just so long as your total contributions to all of them in any tax year don't exceed the $2,000 limit for individual taxpayers and $2,250 for spousal IRAs.

Are you required to contribute to an IRA every year?

As far as the IRS is concerned, no.

Can you move money from one IRA to another?

As far as the IRS is concerned, yes — provided you follow its rules.

You are allowed one rollover between IRAs every 12 months or more. With a rollover you can withdraw the money yourself and you have 60 days to invest the money in another IRA. If you fail to put the money in another IRA within 60 days, it will be considered a distribution.

Bear in mind, however, that there may be withdrawal fees or penalities charged by the sponsor of the IRA being rolled over.

Are there other kinds of IRA rollovers?

Yes. If you are given a distribution from a pension or retirement plan at work, you can shelter it from taxation by rolling it over into an IRA or IRAs within 60 days. Or if you wish, you would take part of the distribution into your income for that year (and pay taxes on it), and roll the remainder over into an IRA or IRAs.

What are the rules on withdrawing money from an IRA after you reach age 59½?

Between ages 59½ and 70½, you may withdraw as much or as little as you like. After age 70½, you must either take it all in a lump sum or take minimum annual payments based on your life expectancy, or the combined life expectancy of you and your spouse.

In addition to taking money out before age 59½, are there any other actions that can subject people with IRAs to IRS penalties?

Yes, and for some, the penalties can be even more severe than for a premature distribution. If you engage in what the IRS calls a "prohibited transaction," your entire IRA is disqualified and must be taken into ordinary income for that year.

In addition, if you are below age 59½ and are not disabled, you would have to pay the 10-percent premature distribution tax.

What are these "prohibited transactions?

Borrowing money from your IRA, selling property to your IRA, and receiving "unreasonable compensation" for managing your IRA.

Can you use your IRA as security for a loan?

No.

Suppose I contribute too much to an IRA?

You can avoid most penalties by withdrawing the excess contribution, as well as all the earnings, before you file your federal income tax return for that year. However, if you are under age 59½ and are not disabled, you will have to pay a 10-percent premature distribution tax on the earnings of the excess contribution.

As an alternative, under some circumstances you can carry the excess contribution forward into the following year. In this case, however, you would have to pay a 6-percent excise tax on it for each year it remains in your IRA until the excess is credited against an allowable future year contribution.

If I withdrew money from an IRA before I was age 59½, how would the IRS know about it?

The sponsor is required to report it to the IRS. You are also required to file a special tax form reporting it. The sponsor is also required to report all other distributions from your IRA, with information copies of the reporting forms sent to you.

What are the new contribution rules for spousal IRAs?

In addition to the higher limit of $2,250 (or 100 percent of income, whichever is less), it's no longer required that spousal IRAs be divided equally between two spouses.

What happens if the unmarried spouse gets a job or earns other compensation during the year?

In that case a spousal IRA contribution cannot be made. However, a regular IRA contribution could be made, governed by the more liberal rules for such a contribution.

Can a couple with a spousal IRA combine the money in a single account or investment?

No. As before, each spouse must have his or her IRA. However, if they wish each can name the other as beneficiary.

What happens if there's a divorce?

Under the new rules, a divorced spouse is allowed to use alimony along with compensation as a basis for contribution to a "divorced spouse" IRA, if certain conditions are met.

The new rules allow contributions if an IRA was established for the divorced spouse at least five years before the divorce. Also, the former spouse must have made spousal contributions to the divorced spouse's IRA for at least three of the five years preceding the divorce.

If these conditions are met, contributions can be made up to the lesser of $1,125 or the total of the divorced spouse's compensation and alimony included in gross income. (If the divorced spouse has compensation of more than $1,125, however, a regular IRA contribution can be made up to the higher limits as long as no alimony is counted.)

Must working couples file a joint return if they both have IRAs?

No. They may file individual returns if they wish. (The requirement for a joint return applies only if a working spouse makes and wishes to deduct an IRA contribution for a non-working spouse.)

For married couples, would an IRA affect the new marriage penalty deduction in the tax law?

Yes. In 1982, a two-earner married couple filing a joint return may deduct from gross income up to 5 percent of the first $30,000 of income earned by the low-earning spouse. This deduction will increase to 10 percent after 1982.

If the lower-earning spouse has an IRA, the IRA deduction must be taken first. This will reduce that spouse's earned income for purposes of the marriage penalty deduction.

For instance if the lower-earning spouse earned $10,000 in 1982, the deduction without an IRA would be 5 percent of that, or $500. But if that spouse had contributed $2,000 to an IRA, the $2,000 would have to be subtracted from the $10,000 before calculating the marriage penalty deduction in this case 5 percent of $8,000, or $400, a difference of $100.

If you have an IRA, must you file any extra forms at income tax time?

Only if you owe a penalty tax for that year. In that case, you must file a form 5329, "Return for Individual Retirement Arrangement Taxes."

KEOGH PLANS

How much time do people have to open Keogh plans and shelter 1982 income from taxation?

Until Dec. 31, 1982. However, the full contribution need not be made until April 15, 1983, or the date when people file their 1982 tax return.

What are the major differences between Keogh plans and IRAs?

All Keogh income must come from self-employment or owning your own business. In addition, the annual contribution limit is now $15,000 or 15 percent of income, whichever is less. And if you have employees who have been working for you at least three years, you must include them in your Keogh plan.

As with IRAs, you are subject to the premature distribution penalty if you take money out of a Keogh plan before age 59½. However, where IRAs allow you to take as much or as little out as you wish each year between ages 59½ and 70½. With a Keogh plan, you must either take it all in a lump sum or start a regular withdrawal program.

Also, Keogh plans cannot be "rolled over" into other Keogh plans so you cannot change investments by handling the money yourself. To change investments, you must give written instructions and the money must be transferred directly from one sponsor to another.

Are the rules and penalties for premature distribution, excess contributions, and prohibited transactions the same for Keogh plans as for IRAs?

Substantially, yes. However, when the Keogh plan sponsor has employees, there may be other adverse tax consequences, as well. For details, consult a tax adviser.

Are you required to contribute to a Keogh plan every year?

Only if you have employees who are covered by the plan. Anyone with a Keogh plan has or is considering hiring employees should consult with a tax adviser on these rules.

NEW IRA/KEOGH RETIREMENT ACCOUNT

What is the new IRA/Keogh retirement account?

A new time deposit category available only to IRA and Keogh account holders. It can be offered by any insured financial institutions that are subject to federal supervision.

How does the new IRA/Keogh retirement account work?

It has a minimum term of 1½ years and is not subject to regulated interest rate ceilings. This means an institution may issue these accounts either with any fixed rate is wishes, or with an interest rate that floats (changes periodically).

May these accounts have terms longer than 18 months?

Yes. The 18 months is a minimum only. An institution may offer them for any longer term up to 10 years.

If the interest rate is to change periodically, on what basis can changes be made?

Either of two methods may be used.

In one, changes are controlled by movements of an index that must be readily verifiable and beyond the institution's control. Examples include interest rates on U.S. Teasury securities, commercial paper and other actively traded financial instruments.

In the other, changes are made according to a predetermined earnings schedule. The institution may establish any predetermined schedule it wishes. For instance, it could establish one paying 12 per cent for the first six months, 12.5 per cent for the next six months and 13 per cent fo the third six-month period.

Are institutions requjred to accept additions during the term of the account?

No. Whether additions will be accepted is optional with the instituiton and is established in your certificate contract.

If an addition is made during the term of an account but the interest rate has changed, because of a change in either an index or a predetermined earnings schedule, which interest rate applies to the addition?

The rate in effect at the time the addition is made. Thereafter, of course, the rate on the addition will further change if there are further changes in the index or schedule.

What is the penalty for early withdrawl from the new IRA/Keogh account?

The loss of at least six months earnings on the amount withdrawn, calculated as a simple interest rate. The penalty applies irrespetive of how long the money has been in account.

What happens at the end of the account term?

If it contains an automatic renewal clause, it will be automatically renewed unless (1) it is withdrawn within a grace period of 7-10 days after maturity, as specified in the contract or (2) the institution gives notice that the account will not be renewed on its previous terms. In that case, the account coverts to a regular savings account and is paid the regular rate. If it is not automatically renewable, then it reverts to regular rate without such notice.

If the account is renewed, must the interest be paid on the same basis as when it was originally issued?

No. It can be calculated in a different way. But if the association changes the basis on which the interest is paid, it must give written notice to the account holder explaining the change at least 15 days before the maturity date.

— United States League of Savings Associations

The chart (below) shows how a $2,000-per-year IRA contribution would appreciate in value. At right, the growing black bar shows how much faster your money grows by not paying taxes on $2,000 saved per year. (Graph assumes 10-percent return and 25-percent tax bracket.)

	Years			
Rate	**5**	**10**	**20**	**30**
10%	$13,529	$35,566	$129,933	$380,318
11%	$12,947	$37,771	$147,976	$469,529
12%	$14,379	$40,128	$168,826	$581,576
13%	$14,824	$42,605	$192,936	$722,487
Total contributions	$10,000	$20,000	$40,000	$60,000