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What distributions do you have to take from your IRA in 2009?

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With all the turmoil that has taken place in the financial markets, many Naperville residents question what distribution they must take out of their IRA by law this year. In the past years, once a retiree attained the age of 70 1/2, that retiree was required to take a distribution from the IRA each year based on the life expectancy tables provided by the IRS, whether they desired to take the distribution or not. If they failed to take the distribution, there was a large 50 percent excise tax on the amount they should have withdrawn.

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Under existing law, every person who contributes to a tax deferred retirement account, such as a traditional IRA or 401(k), does not pay any income tax on the amount as it is contributed to such account. Once deposited in such account, the amounts contributed earn money tax free. However, the law requires that eventually the amount saved in this process must be taken out and tax be paid on the funds withdrawn. The law requires that a holder of an IRA begin withdrawing money from these accounts by April 1 of the year after they attain the age of 70 1/2. The amount that a person must withdraw changes each year, based on the life expectancy tables provided by the IRS. Once you attain that age, you can always take more out of the IRA, but you cannot take less, without the assessment of a penalty of 50 percent of the amount that should have been withdrawn.

The law was changed for the 2009 tax period, as the new legislation allows the retiree to skip the distribution for 2009 (if the retiree so desires) without any penalty. This only lasts for the year 2009, which was intended to give the retirement assets in the IRA some time to recover from the sharp drop in the stock market. Unless this provision is extended by the new Congress, those who are older than 70 1/2 (and all those who have inherited IRAs or 401(k)s will be required to begin taking distributions again in 2010.

Under current law, if you turned age 70 1/2 in 2009, you could normally wait until April 2010 to take your first withdrawal. If you waited until that point to take your first withdrawal, the law required you to take two distributions in 2010: one for 2009 (the first distribution) and one for 2010 (the second distribution, which would have to be taken by Dec. 31, 2010.) Under the new law, you will not have to take the first distribution by April 1, 2010; instead, you will only have to take the second by Dec. 31, 2010.

If you inherited an IRA and are taking out money under a five-year deadline, based on the new law, you can skip your withdrawal in 2009. This law allows you to stretch out your required distributions for another year.

In the bailout package that Congress enacted last October, the tax break that allowed a taxpayer to make a contribution to a charity if you were 70 1/2 was extended. Under that law, individuals ages 70 1/2 and older can donate as much as $100,000 to a public charity, with no taxes due on the withdrawal and that withdrawal counts as your required distribution. The latest legislation still allows you to donate money from your IRA to charity without paying income taxes on it first, although with mandatory distributions suspended and the values in the retirement accounts having diminished as they have, it does not have the same appeal to a taxpayer. However, you can still make the withdrawal tax free as a direct donation to a charity in 2009, if you so desire.

Although the law on distributions from an IRA or 401(k) plan are normally confusing, this new adjustment to the law should allow retirees who do not need the distribution to live on to keep the money in the plan or keep from liquidating money from an investment that may improve. All in all, it is a good plan.

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