Important changes on traditional IRAs

The traditional Individual Retirement Account (IRA) was established in the United States by the Employees Retirement Income Security Act of 1974 (ERISA). These IRAs became available in 1975.

The benefit of a traditional IRA is that it allows an individual to save money for retirement in a tax-advantaged way. The IRA is set up at a financial institution, which allows contributions to grow on a tax-deferred basis. Specifically, contributions to traditional IRAs generally lower the individuals’ taxable income (adjusted gross income) in the contribution year. Contributions and earned interest continue to grow over the years.

Anyone with earned income can make the maximum traditional IRA contribution as long as he or she has at least that much income in a given year. (Qualification for a full or partial tax deduction depends mostly on the individual’s income and whether he or she has access to a work-related retirement account like a 401(k).) A non-working spouse can establish his/her own traditional IRA if the earned income of the working spouse equals or exceeds the total contribution to both partners’ IRAs.

Taxes are paid on the traditional IRA only when a withdrawal is made from the account. A penalty may be applied if the withdrawal is made prior to the owner attaining 59.5 years of age.

The IRA maximum contribution limits have increased over the years. They started in 1975 with a $1,500 limit. The contribution limit increased in the following years: 1982 ($2,000), 2002 ($3,000), 2005 ($4,000), 2008 ($5,000), 2013 ($5,500), and 2019 ($6,000).

Starting in 2002, individuals aged 50 or older were allowed to make additional “catch-up” contributions to their traditional IRAs. Catch-up contributions were $500 from 2002-2005 and $1,000 from 2006-2019.

For the 2020 tax year, the total contribution to all of an individual’s traditional and Roth IRAs cannot exceed: $6,000 ($7,000 if the individual is age 50 or older), or the taxable compensation for the year, if the compensation was less than this dollar limit.

Until 2020, people were unable to make contributions to a traditional IRA once they reached 70.5 years of age, regardless of whether they had earned income or not. In addition, traditional IRAs had a required minimum distribution (RMD) requirement that began at age 70.5. This RMD is the minimum amount an individual must withdraw from the traditional IRA each year. The amount of the RMD is based on the age of the IRA owner and the value of the account at the end of a calendar year.

The Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act), which was signed into law on Dec. 20, 2019, has made changes to the traditional IRA.

Section 106 of The SECURE Act repealed the prohibition on contributions to a traditional IRA by an individual who has attained age 70.5. As Americans live longer, an increasing number continue employment beyond traditional retirement age. This change will allow individuals who still have earned income to continue contributing to their IRA for years, thereby providing a more secure financial future. Although contributions may be made for additional years, the maximum annual contribution limit still applies.

Section 113 of The SECURE Act increased the age for which a required minimum distribution was mandatory, from age 70.5 to 72. The rationale behind the RMD rule is to ensure that individuals spend their retirement savings during their lifetime and not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries. The original age of RMD (70.5 years of age) was first applied in the retirement plan context in the early 1960s and has never been adjusted to consider increases in life expectancy. The increase in the age of mandatory withdrawal of funds allows individuals to let their funds remain in the IRA for a longer period of time. This allows additional tax-deferred earning of interest.

In January of each year, the MBA sends a written notification to all traditional IRA policy owners who are required to take an RMD from their plan. The notification also informs the policy owner of the amount of the RMD. Beginning in 2020, the MBA will be sending notifications only to those traditional IRA owners who are age 72 or older.

Contributions for a traditional IRA, as well as a Roth IRA, may be made up to the tax filing deadline of any given year. The last date to contribute to an IRA for the 2019 tax year is April 15, 2020. If you are making a traditional IRA or Roth IRA contribution for the 2019 tax year, please indicate on the check or money order that the “contribution is for the 2019 tax year.”