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# Traditional and Roth Individual Retirement Accounts (IRAs): A Primer

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## Summary

In response to concerns over the adequacy of retirement savings, Congress has created incentives to encourage individuals to save more for retirement through a variety of retirement plans. Some retirement plans are employer-sponsored, such as 401(k) plans, and others are established by individual employees, such as Individual Retirement Accounts (IRAs).

This report describes the primary features of two common retirement savings accounts that are available to individuals. Although the accounts have many features in common, they differ in some important aspects. Both traditional and Roth IRAs offer tax incentives to encourage individuals to save for retirement. Contributions to traditional IRAs may be tax-deductible for taxpayers who (1) are not covered by a retirement plan at their place of employment or (2) have income below specified limits. Contributions to Roth IRAs are not tax-deductible and eligibility is limited to those with incomes under specified limits.

The tax treatment of distributions from traditional and Roth IRAs differs. Distributions from traditional IRAs are generally included in taxable income whereas distributions from Roth IRAs are not included in taxable income. Some distributions may be subject to an additional 10% tax penalty, unless the distribution is for a reason specified in the Internal Revenue Code (for example, distributions from IRAs after the individual is aged 59 ½ or older are not subject to the early withdrawal penalty).

Individuals may rollover eligible distributions from other retirement accounts (such as an account balance from a 401(k) plan upon leaving an employer) into IRAs. Rollovers preserve retirement savings by allowing investment earnings on the funds in the retirement accounts to accrue on a tax-deferred, in the case of traditional IRAs, or a tax-free basis, in the case of Roth IRAs.

The Retirement Savings Contribution Credit (also known as the Saver's Credit) is a non-refundable tax credit of up to \$1,000. It was authorized in 2001 to encourage retirement savings among individuals with income under specified limits.

This report explains the eligibility requirements, contribution limits, tax deductibility of contributions, rules for withdrawing funds from the accounts, and provides data on the account holdings. It also describes the Saver's Credit and provisions enacted after the Gulf of Mexico hurricanes in 2005 and the Midwestern storms in 2008 to exempt distributions to those affected by the disasters from the 10% early withdrawal penalty.

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## Introduction

Individual Retirement Accounts (IRAs) are tax-advantaged accounts that individuals (or married couples) can establish to accumulate funds for retirement. Depending on the type of IRA, contributions may be made on a pre-tax or post-tax basis, and investment earnings are either tax-deferred or tax-free.<sup>1</sup>

IRAs were first authorized by the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406). Originally limited to workers without pension coverage, all workers and spouses were made eligible for IRAs by the Economic Recovery Act of 1981 (P.L. 97-34). The Tax Reform Act of 1986 (P.L. 99-514) limited the eligibility for tax-deductible contributions to individuals whose employers do not sponsor plans and to those whose employers sponsor plans but who have earnings below certain thresholds. The Taxpayer Relief Act of 1997 (P.L. 105-34) allowed for certain penalty-free withdrawals and authorized the Roth IRA, which provides tax-free growth from after-tax contributions.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) significantly affected the contribution limits in these plans in three ways: (1) it increased the limits, (2) it indexed the limits to inflation, and (3) it allowed for individuals aged 50 and older to make additional “catch-up” contributions. Among other provisions, the Pension Protection Act of 2006 (P.L. 109-280) temporarily allowed for tax-free distributions for charitable contributions; made permanent the indexing of contribution limits to inflation; and allowed taxpayers to direct the Internal Revenue Service (IRS) to deposit tax refunds directly into an IRA.<sup>2</sup>

This report describes the two kinds of IRAs that individual employees can establish: traditional IRAs and Roth IRAs.<sup>3</sup> It describes the rules regarding eligibility, contributions, and withdrawals. It also describes a tax credit for retirement savings contributions. An **Appendix** explains rules related to penalty-free distributions for those affected by the 2005 Gulf of Mexico hurricanes and the 2008 Midwestern floods. The Appendix also describes relief provided by the IRS to those affected by Hurricane Sandy in 2012.

## Traditional IRAs

Traditional IRAs are funded by workers’ contributions, which may be tax-deductible. The contributions accrue investment earnings in an account, and these earnings are used as a basis for retirement income. Among the benefits of traditional IRAs, two are (1) pre-tax contributions, which provide larger bases for accumulating investment earnings and, thus, provide larger account balances at retirement than if the money had been placed in taxable accounts; and (2) taxes are paid when funds are distributed. Since income tax rates in retirement are often lower than during working life, traditional IRA holders are likely to pay less in taxes when contributions are withdrawn than when the income was earned.

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<sup>1</sup> For more information on the tax treatment of retirement savings, including Individual Retirement Accounts (IRAs), see U.S. Congress, Joint Committee on Taxation, *Present Law And Background Relating To The Tax Treatment Of Retirement Savings*, prepared by Joint Committee on Taxation, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., April 13, 2012, JCX-32-12.

<sup>2</sup> See also 26 U.S.C. §408 for traditional IRAs and 26 U.S.C. §408A for Roth IRAs.

<sup>3</sup> There are also two kinds of IRAs established by employers for employees in small businesses: Simplified Employee Pensions (SEP-IRA) and Savings Incentive Match Plans for Employees (SIMPLE-IRA). These are not discussed in this report.

## **Eligibility**

Individuals under 70½ years old in a year and who receive taxable compensation can set up and contribute to IRAs. Examples of compensation include wages, salaries, tips, commissions, self-employment income, alimony, and nontaxable combat pay. Individuals who receive income only from non-compensation sources cannot contribute to IRAs.

## **Contributions**

Individuals may contribute either their gross compensation or the contribution limit, whichever is lower. In 2016, the contribution limit is \$5,500 unchanged from 2015. Since 2009, the contribution limit has been indexed to inflation. Individuals aged 50 and older may make additional \$1,000 catch-up contributions. For households that file a joint return, spouses may contribute an amount equal to the couple's total compensation (reduced by the spouse's IRA contributions) or the contribution limit (\$5,500 each, if younger than the age of 50, and \$6,500 each, if 50 years or older), whichever is lower. Contributions that exceed the contribution limit and are not withdrawn by the due date for the tax return for that year are considered excess contributions and are subject to a 6% "excess contribution" tax. Contributions made between January 1 and April 15 may be designated for either the current year or the previous year.

Because IRAs were intended for workers without an employer-sponsored pension to save for retirement, contributions to an IRA may only come from work income, such as wages and tips. The following non-compensation sources of income cannot be used for IRA contributions:

- earnings from property, interest, or dividends;
- pension or annuity income;
- deferred compensation;
- income from partnerships for which an individual does not provide services that are a material income-producing factor; and
- foreign earned income.

## **Investment Options**

IRAs can be set up through many financial institutions, such as banks, credit unions, mutual funds, life insurance companies, or stock brokerages. Individuals have an array of investment choices offered by the financial institutions and can transfer their accounts to other financial institutions at will.

Several transactions could result in additional taxes or the loss of IRA status. These transactions include borrowing from IRAs; using IRAs as collateral for loans; selling property to IRAs; and investing in collectibles like artwork, antiques, metals, gems, stamps, alcoholic beverages, and most coins.<sup>4</sup>

## **Deductibility of Contributions**

IRA contributions may be non-tax-deductible, partially tax-deductible, or fully tax-deductible, depending on whether the individual or spouse is covered by a pension plan at work and their

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<sup>4</sup> Gold, silver, and platinum coins issued by the U.S. Treasury, and gold, silver, palladium, and platinum bullion are permissible.

level of adjusted gross income (AGI). Individuals are covered by a retirement plan if (1) the individuals or their employers have made contributions to a defined contribution pension plan or (2) the individuals are eligible for a defined benefit pension plan (even if they refuse participation).

For individuals and households *not* covered by a pension plan at work, **Table 1** contains the income levels at which they may deduct all, some, or none of their IRA contributions, depending on the spouse’s pension coverage and the household’s AGI. Individuals without employer-sponsored pensions and, if married, whose spouse also does not have pension coverage may deduct up to the contribution limit from their income taxes regardless of their AGI.

For individuals and households who are covered by a pension plan at work, **Table 2** contains the income levels at which they may deduct all, some, or none of their IRA contributions, depending on the individual’s or household’s AGI.

Individuals may still contribute to IRAs up to the contribution limit even if the contribution is non-deductible. Non-deductible contributions come from post-tax income, not pre-tax income. One advantage to placing post-tax income in traditional IRAs is that investment earnings on non-deductible contributions are not taxed until distributed. Only contributions greater than the contribution limits as described above are considered excess contributions. Worksheets for computing partial deductions are included in “IRS Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs).”<sup>5</sup>

**Table 1. Deductibility of IRA Contributions for Individuals Not Covered by a Plan at Work for 2015 and 2016**

Filing Status	2015 Adjusted Gross Income	2016 Adjusted Gross Income	Deduction Allowed
Single, head of household, qualifying widow(er), or married filing jointly or separately with a spouse who is not covered by a plan at work	Any amount	Any amount	Full deduction
Married filing jointly with a spouse who is covered by a plan at work	\$183,000 or less	\$184,000 or less	full deduction
	More than \$183,000 but less than \$193,000	More than \$184,000 but less than \$194,000	Partial deduction
	\$193,000 or more	\$194,000 or more	No deduction
Married filing separately with a spouse who is covered by a plan at work	Less than \$10,000	Less than \$10,000	Partial deduction
	\$10,000 or more	\$10,000 or more	No deduction

**Source:** IRS Publication 590-A, available at <http://www.irs.gov/publications/p590a/> and IRS News Release IR-2015-118 available at <https://www.irs.gov/pub/irs-news/IR-15-118.pdf>.

<sup>5</sup> The publication is available on the Internal Revenue Service (IRS) website at <http://www.irs.gov/publications/p590a>.

**Table 2. Deductibility of IRA Contributions for Individuals Covered by a Plan at Work for 2015 and 2016**

Filing Status	2015 Adjusted Gross Income	2016 Adjusted Gross Income	Deduction Allowed
Single or head of household	\$61,000 or less	\$61,000 or less	Full deduction
	More than \$61,000 but less than \$71,000	More than \$61,000 but less than \$71,000	Partial deduction
	\$71,000 or more	\$71,000 or more	No deduction
Married filing jointly or qualifying widow(er)	\$98,000 or less	\$98,000 or less	Full deduction
	More than \$98,000 but less than \$118,000	More than \$98,000 but less than \$118,000	Partial deduction
	\$118,000 or more	\$118,000 or more	No deduction
Married filing separately	Less than \$10,000	Less than \$10,000	Partial deduction
	\$10,000 or more	\$10,000 or more	No deduction

**Source:** IRS Publication 590-A, available at <http://www.irs.gov/publications/p590a/> and IRS News Release IR-2015-118 available at <https://www.irs.gov/pub/irs-news/IR-15-118.pdf>.

Note: The change in the Consumer Price Index from 2015 to 2016 was insufficient for a change to the phase-out limits for the deduction of IRA contributions for individuals who were covered by a pension plan at work.

## Withdrawals

Withdrawals from IRAs are subject to income tax in the year that they are received.<sup>6</sup> Early distributions are withdrawals made before the age of 59½. Early distributions may be subject to an additional 10% penalty.

To ensure that IRAs are used for retirement income and not for bequests, IRA holders must begin making withdrawals by April 1 of the year after reaching the age of 70½ (i.e., the required beginning date). The minimum amount that must be withdrawn (i.e., the required minimum distribution) is calculated by dividing the account balance on December 31 of the year preceding the distribution by the IRA owner’s life expectancy as found in IRS Publication 590-B.<sup>7</sup> Although females live longer on average than males, the IRS does not separate life expectancy tables for males and females for this purpose.<sup>8</sup> Required minimum distributions must be received by December 31 of each year. Failure to take the required minimum distribution results in a 50% excise tax on the amount not distributed as required. Congress suspended the Required Minimum Distribution (RMD) provision for 2009.<sup>9</sup>

<sup>6</sup> For a detailed explanation of withdrawals from IRAs, see CRS Report R40192, *Early Withdrawals and Required Minimum Distributions in Retirement Accounts: Issues for Congress*, by (name redacted) .

<sup>7</sup> Life expectancy is calculated differently depending on whether the account holder (1) is single and an IRA beneficiary, (2) has a spouse who is more than 10 years younger, (3) has a spouse who is not more than 10 years younger, (4) whose spouse is not the sole beneficiary, or (5) is unmarried.

<sup>8</sup> The Supreme Court ruled in *Arizona Governing Comm. vs. Norris*, 463 U.S. 1073 (1983), that employer-provided pension plans must use unisex tables in calculating monthly annuity benefits. Citing this ruling, the IRS constructs its own unisex life expectancy tables. See 26 U.S.C. §417(e)(3)(A)(ii).

<sup>9</sup> Congress did not enact any of the proposals that were introduced to suspend the RMD in years after 2009. See CRS Report R40192, *Early Withdrawals and Required Minimum Distributions in Retirement Accounts: Issues for Congress*.



Beginning in 2007, distributions from IRAs after the age of 70½ could be made directly to qualified charities and excluded from gross income. This provision for Qualified Charitable Distributions expired December 31, 2013.<sup>10</sup>

## Early Distributions

Early distributions are withdrawals made before the age of 59½. Early distributions—just like distributions after the age of 59½—are subject to federal income tax. To discourage the use of IRA funds for pre-retirement uses, most early distributions are subject to a 10% tax penalty.<sup>11</sup> The early withdrawal penalty does not apply to distributions before the age of 59½ if they

- occur if the individual is a beneficiary of a deceased IRA owner;
- occur if the individual is disabled;
- are in substantially equal payments over the account holder’s life expectancy;
- are received after separation from employment after the age of 55;
- are for unreimbursed medical expenses in excess of 7.5% of AGI;
- are for medical insurance premiums in the case of unemployment;
- are used for higher education expenses;
- are used to build, buy, or rebuild a first home up to a \$10,000 withdrawal limit;
- occur if the individual is a reservist called to active duty after September 11, 2001;
- were distributions to residents in areas affected by Hurricanes Katrina, Rita, and Wilma from around the storms’ landfalls to January 1, 2007; or
- were distributions to residents in areas affected by the Midwestern floods in 2008 from after the applicable disaster date and before January 1, 2010.

Although individuals may make early withdrawals from IRAs without a reason, they will be subject to the 10% tax penalty unless they meet one of the conditions above. There are no other general “hardship” exceptions for penalty-free distributions from IRAs.

## Rollovers

Rollovers are transfers of assets from one retirement plan to another upon separation from the original employer. Rollovers are not subject to the 59½ rule, the 10% penalty, or the contribution limit. Rollovers can come from traditional IRAs, employers’ qualified retirement plans (e.g., 401(k) plans), deferred compensation plans of state or local governments (Section 457 plans), tax-sheltered annuities (Section 403(b) plans), or the Thrift Savings Plan for federal employees.

Rollovers can be either direct trustee-to-trustee transfers<sup>12</sup> or issued directly to individuals who then deposit the rollovers into traditional IRAs. Individuals have 60 days to make rollover contributions. Rollovers not completed within 60 days are considered taxable distributions and may be subject to the 10% early withdrawal penalty. In addition, in cases where individuals

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<sup>10</sup> See CRS Report RS22766, *Qualified Charitable Distributions from Individual Retirement Accounts: Features and Legislative History*, by (name redacted) and (name red acted)

<sup>11</sup> See 26 U.S.C. §72(t).

<sup>12</sup> A trustee-to-trustee transfer is a transfer of funds made directly between two financial institutions. The individual does not take possession of the funds at any point.

directly receive a rollover, 20% of the rollover is withheld for tax purposes. Direct trustee-to-trustee transfers are not subject to withholding taxes. In cases where individuals directly receive a rollover, they must have an amount equal to the 20% withheld available from other sources to place in the new IRA. If the entire distribution is rolled over within 60 days, the amount withheld is applied to individuals' income taxes paid for the year.

### **Rollovers Limited to One Per Year**

A January 2014 U.S. Tax Court decision required that, in certain circumstances, individuals are limited to a total of one rollover per year for their IRAs.<sup>13</sup> Rollovers subject to this rule are those between two IRAs in which an individual receives funds from an IRA and deposits the funds into a different IRA within 60 days. The one-rollover-per-year limit applies to rollovers between two traditional IRAs or two Roth IRAs. It does not apply to rollovers from a traditional IRA to a Roth IRA. The limitation does not apply to trustee-to-trustee transfers or rollovers from qualified pension plans (such as from 401(k) plans).

### **Inherited IRAs**

When the owner of an IRA dies, ownership passes to the account's designated beneficiary or, if no beneficiary has been named, to the decedent's estate. Federal law has different distribution requirements depending on whether the new owner is a

- designated beneficiary who is the former owner's spouse;
- designated beneficiary who is not the former owner's spouse; or
- non-designated beneficiary.

The distribution rules are summarized in **Table 3**. The distribution rules also depend on whether the IRA owner died prior to the required beginning date, the date on which distributions from the account must begin. It is April 1 of the year following the year in which the owner of an IRA reaches the age of 70½. Distributions from inherited IRAs are taxable income but are not subject to the 10% early withdrawal penalty. Failure to take the RMD results in a 50% excise tax on the amount not distributed as required.

Designated spouse beneficiaries who treat inherited IRAs as their own can roll over inherited IRAs into traditional IRAs or, to the extent that the inherited IRAs are taxable, into qualified employer plans (such as 401(k), 403(b), or 457 plans). Non-spouse beneficiaries cannot roll over any amount into or out of inherited IRAs.

In some cases, IRAs have beneficiaries' distributions requirements that are more stringent than those summarized in **Table 3**. For example, an IRA's plan documents could require that a designated spouse or designated nonspouse beneficiary distribute all assets in the IRA by the end of the fifth year of the year following the IRA owner's death. In such a case, the beneficiary would not have the option to take distributions over a longer period of time. Unless the IRA plan documents specify otherwise, it is possible to take distributions faster than required in **Table 3**. For example, a beneficiary may elect to distribute all assets in a single year. In such a case, the entire amount distributed is taxable income for that year.

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<sup>13</sup> See *Bobrow vs. Commissioner* - U.S. Tax Court, available at <http://www.ustaxcourt.gov/InOpHistoric/bobrowmemo.nega.TCM.WPD.pdf>. Prior to this decision, the IRS applied the one-rollover-per-year on an IRA-by-IRA basis.

**Table 3. Inherited IRA Distribution Rules**

	<b>Owner Dies Before Required Beginning Date</b>	<b>Owner Dies after Required Beginning Date</b>
Spouse is named as the designated beneficiary	Treat as own, does not have to take any distribution until the age of 70½, but is subject to the 59½ rule, or Keep in decedent's name and take distributions based on own life expectancy. Distributions do not have to begin until decedent would have turned 70½.	Treat as own, does not have to take any distribution until the age of 70½, but is subject to the 59½ rule, or Keep in decedent's name and take distributions based on own life expectancy.
A nonspouse is named as the designated beneficiary	Take distributions based on life expectancy for beneficiary's age as of birthday in the year following the year of the owner's death, reduced by one for each year since owner's death. If the nonspouse beneficiary does not take a distribution in year of owner's death, then all IRA assets must be distributed by the end of the fifth year of the year following the IRA owner's death.	Take distributions based on the longer of (1) beneficiary's life expectancy, or (2) owner's life expectancy using age as of birthday in the year of death, reduced by one for year after the year of death.
Beneficiary is not named	Must distribute all IRA assets by the end of the fifth year of the year following the IRA owner's death.	Take a yearly distribution based on the owner's age as of birthday in the year of death, reduced by one for each year after the year of death.

**Source:** IRS Publication 590-B, available at <http://www.irs.gov/publications/p590b/>.

**Notes:** The required beginning date is the date on which distributions from the account must begin. It is April 1 of the year following the year in which the owner of an IRA reaches the age of 70½.

## Roth IRAs

Roth IRAs were authorized by the Taxpayer Relief Act of 1997 (P.L. 105-34). The key differences between traditional and Roth IRAs are that contributions to Roth IRAs are made with after-tax funds and qualified distributions are not included in taxable income; hence, investment earnings accrue free of taxes.<sup>14</sup>

### Eligibility and Contribution Limits

In contrast to traditional IRAs, Roth IRAs have income limits for eligibility. **Table 4** lists the adjusted gross incomes at which individuals may make the maximum contribution and the ranges in which this contribution limit is reduced. For example, a 40-year-old single taxpayer with income of \$90,000 can contribute \$5,500 in 2016. A similar taxpayer making \$120,000 would be subject to a reduced contribution limit, whereas a taxpayer with income of \$140,000 would be ineligible to contribute to a Roth IRA.

<sup>14</sup> Roth IRAs are named for former Senator William Roth (DE).

**Table 4. Roth IRA Eligibility and Contribution Limits for 2015 and 2016**

Filing Status	2015 Modified Adjusted Gross Income (AGI)	2015 Contribution Limits	2016 Modified Adjusted Gross Income (AGI)	2016 Contribution Limits
Single, head of household, married filing separately (and did not live with spouse at any time during the year)	Less than \$116,000	\$5,500 (\$6,500 if 50 years or older) or AGI, whichever is smaller	Less than \$117,000	\$5,500 (\$6,500 if 50 years or older) or AGI, whichever is smaller
	At least \$116,000 but less than \$131,000	Reduced contribution limit	At least \$117,000 but less than \$132,000	Reduced contribution limit
	\$131,000 or more	Ineligible to contribute	\$132,000 or more	Ineligible to contribute
Married filing separately and lived with spouse at any time during the year	Less than \$10,000	Reduced contribution limit	Less than \$10,000	Reduced contribution limit
	\$10,000 or more	Ineligible to contribute	\$10,000 or more	Ineligible to contribute
Married filing jointly, qualifying widow(er)	Less than \$183,000	\$5,500 each (\$6,500 each if 50 and older) or AGI, whichever is smaller	Less than \$184,000	\$5,500 each (\$6,500 each if 50 and older) or AGI, whichever is smaller
	At least \$183,000 but less than \$193,000	Reduced contribution limit	At least \$184,000 but less than \$194,000	Reduced contribution limit
	\$193,000 or more	Ineligible to contribute	\$194,000 or more	Ineligible to contribute

**Source:** IRS Publication 590-A, available at <http://www.irs.gov/publications/p590a/> and IRS News Release IR-2015-118 available at <https://www.irs.gov/pub/irs-news/IR-15-118.pdf>.

Individuals aged 50 and older can make additional \$1,000 catch-up contributions. The AGI limit for eligibility has been adjusted for inflation since 2007; beginning in 2009, the traditional and Roth IRA contribution limit has also been adjusted for inflation. A worksheet for computing reduced Roth IRA contribution limits is provided in IRS Publication 590-A.

## Investment Options

Roth IRAs must be designated as such when they are set up. As with traditional IRAs, they can be set up through many financial institutions. Transactions prohibited within traditional IRAs are also prohibited within Roth IRAs.

## Conversions and Rollovers

Individuals may convert amounts from traditional IRAs, SEP-IRAs, or SIMPLE-IRAs to Roth IRAs.<sup>15</sup> Since 2008, individuals have been able to rollover distributions directly from qualified retirement plans to Roth IRAs. The amount of the conversion must be included in taxable income.

<sup>15</sup> Prior to January 1, 2010, only individuals with income under specified thresholds were eligible to make conversions from traditional to Roth IRAs. The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA; P.L. 109-222) eliminated the income thresholds.

Conversions can be a trustee-to-trustee transfer, a same trustee transfer by redesignating the IRA as a Roth IRA, or a rollover directly to the account holder. Inherited IRAs cannot be converted.

The rules for rollovers that apply to traditional IRAs, including completing a rollover within 60 days, also apply. Additionally, withdrawals from a converted IRA prior to five years from the beginning of the year of conversion are non-qualified distributions and are subject to a 10% penalty.

Tax-free withdrawals from one Roth IRA transferred to another Roth IRA are allowed if completed within 60 days. Rollovers from Roth IRAs to other types of IRAs or to employer-sponsored retirement plans are not allowed.

## **Withdrawals**

The three kinds of distributions from Roth IRAs are (1) return of regular contributions, (2) qualified distributions, and (3) non-qualified distributions. Returns of regular contributions and qualified distributions are not included as part of taxable income.

### **Return of Regular Contributions**

Distributions from Roth IRAs that are a return of regular contributions are not included in gross income nor are they subject to the 10% penalty on early distributions.

### **Qualified Distributions**

Qualified distributions must satisfy both of the following:

- they are made after the five-year period beginning with the first taxable year for which a Roth IRA contribution was made,<sup>16</sup> and
- they are made on or after the age of 59½; because of disability; to a beneficiary or estate after death; or to purchase, build, or rebuild a first home up to a \$10,000 lifetime limit.

### **Non-Qualified Distributions**

Distributions that are neither returns of regular contributions nor qualified distributions are considered non-qualified distributions. Although individuals might have several Roth IRAs from which withdrawals can be made, for tax purposes non-qualified distributions are assumed to be made in the following order:

1. the return of regular contributions,
2. conversion contributions on a first-in-first-out basis, and
3. earnings on contributions.

Non-qualified distributions may have to be included as part of income for tax purposes. A worksheet is available in IRS Publication 590-B to determine the taxable portion of non-qualified distributions. A 10% penalty applies to non-qualified distributions unless one of the exceptions in 26 U.S.C. Section 72(t) applies. The exceptions are identical to those previously listed for early withdrawals from traditional IRAs.

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<sup>16</sup> The five-year period is not necessarily five calendar years. Contributions made from January 1 to April 15 could be considered made in the previous tax year.

## Distributions After Roth IRA Owner’s Death

If the owner of a Roth IRA dies, the distribution rules depend on whether the beneficiary is the spouse or a nonspouse. If the beneficiary is the spouse, then the spouse becomes the new owner of the inherited Roth IRA. If the spouse chooses not to treat the inherited Roth IRA as their own, or if the beneficiary is a nonspouse, then there are two options. The beneficiary can distribute the entire interest in the Roth IRA (1) by the end of the fifth calendar year after the year of the owner’s death, or (2) over the beneficiary’s life expectancy. As with an inherited traditional IRA, a spouse can delay distributions until the decedent would have reached the age of 70½.

Distributions from inherited Roth IRAs are generally free of income tax. The beneficiary may be subject to taxes if the owner of a Roth IRA dies before the end of (1) the five-year period beginning with the first taxable year for which a contribution was made to a Roth IRA or (2) the five-year period starting with the year of a conversion from a traditional IRA to a Roth IRA. The distributions are treated as described in the “Non-Qualified Distributions” section, above.

## Retirement Savings Contribution Credit

The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) authorized a non-refundable tax credit of up to \$1,000 for eligible individuals, or \$2,000 if filing a joint return, who contribute to IRAs or employer-sponsored retirement plans.<sup>17</sup> The tax credit is in addition to the tax deduction for contributions to traditional IRAs or other employer-sponsored pension plans. To receive the credit, taxpayers must be at least 18 years old, not full-time students, not an exemption on someone else’s tax return, and have AGI less than certain limits. The limits are in **Table 5**. For example, individuals who make a \$2,000 IRA contribution in 2016, have income of \$15,000, and list their filing status as single would be able to reduce their 2016 tax liability by up to \$1,000. Taxpayers must file form 1040, 1040A, or 1040NR. It is not available on form 1040EZ, which may limit the use of the credit.

**Table 5. Retirement Saving Contribution Credit Income Limits for 2015 and 2016**

Filing Status	2015 Income Limits	2016 Income Limits	Percentage Credit
Single, Married Filing Separately, Qualifying Widow(er)	\$1 to \$18,250	\$1 to \$18,500	50%
	\$18,251 to \$19,750	\$18,501 to \$20,000	20%
	\$19,751 to \$30,500	\$20,001 to \$30,750	10%
	more than \$30,500	more than \$30,750	0%
Head of Household	\$1 to \$27,375	\$1 to \$27,750	50%
	\$27,376 to \$29,625	\$27,751 to \$30,000	20%
	\$29,626 to \$45,750	\$30,001 to \$46,125	10%
	more than \$45,750	more than \$46,125	0%

<sup>17</sup> See also CRS Report RS21795, *The Retirement Savings Tax Credit: A Fact Sheet*, by (name redacted) .

Filing Status	2015 Income Limits	2016 Income Limits	Percentage Credit
Married Filing Jointly	\$1 to \$36,500	\$1 to \$37,000	50%
	\$36,501 to \$39,500	\$37,001 to \$40,000	20%
	\$39,501 to \$61,000	\$40,001 to \$61,500	10%
	more than \$61,000	more than \$61,500	0%

Source: IRS Publication 590-A, available at <http://www.irs.gov/publications/p590a/> and IRS News Release IR-2015-118 available at <https://www.irs.gov/pub/irs-news/IR-15-118.pdf>.

## Data on IRA Assets, Sources of Funds, and Ownership

Table 6 contains data on the end-of-year assets in traditional and Roth IRAs from 2005 to 2014. According to the Investment Company Institute, traditional IRAs held much more in assets than Roth IRAs. At the end of 2014, there was \$6.4 trillion held in traditional IRAs and \$550 billion held in Roth IRAs. Within traditional IRAs, more funds flowed from rollovers from employer-sponsored pensions compared with funds from regular contributions.<sup>18</sup> For example, in 2012 (the latest year for which such data are available) funds from rollovers were \$301.0 billion, whereas funds from contributions were only \$14.1 billion.<sup>19</sup> However, within Roth IRAs in 2012 more funds flowed from contributions (\$17.7 billion in 2012) than from rollovers (\$4.4 billion in 2012).<sup>20</sup>

**Table 6. Traditional and Roth IRAs: End of Year Assets**  
(in billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Traditional IRAs	3,034	3,722	4,187	3,257	3,941	4,340	4,531	5,109	6,019	6,421
Roth IRAs	156	196	232	177	239	355	365	420	505	550

Source: The Congressional Research Service (CRS) table using data from the Investment Company Institute, The U.S. Retirement Market, Third Quarter 2015, Table 8, available at [http://www.ici.org/info/ret\\_15\\_q3\\_data.xls](http://www.ici.org/info/ret_15_q3_data.xls).

Table 7 provides data on IRA ownership and account balances among households that owned IRAs in 2013 and Table 8 provides data on three types of IRAs: traditional, Roth, and rollover IRAs. The data are from CRS analysis of the 2013 Survey of Consumer Finances (SCF).<sup>21</sup> The SCF is a triennial survey conducted on behalf of the Board of Governors of the Federal Reserve and contains detailed information on U.S. household finances, such as the amount and types of

<sup>18</sup> Generally, rollovers are tax-free distributions of assets from one retirement plan that are contributed to a second retirement plan. Regular contributions are contributions to IRAs that are made from individuals' pre- or post-tax income (subject to the rules of the particular type of IRA).

<sup>19</sup> See the Investment Company Institute, The U.S. Retirement Market, Third Quarter 2015, Table 9, available at [http://www.ici.org/info/ret\\_15\\_q3\\_data.xls](http://www.ici.org/info/ret_15_q3_data.xls).

<sup>20</sup> See the Investment Company Institute, The U.S. Retirement Market, Third Quarter 2015, Table 10, available at [http://www.ici.org/info/ret\\_15\\_q3\\_data.xls](http://www.ici.org/info/ret_15_q3_data.xls).

<sup>21</sup> More information on the SCF is available at <http://www.federalreserve.gov/econresdata/scf/scfindex.htm>.

assets owned, the amount and types of debt owed, and detailed demographic information on the head of the household and spouse. The SCF is designed to be nationally representative of the 122.5 million U.S. households in 2013.

The following are some key points regarding ownership of IRAs:

- 28% of U.S. households had an IRA in 2013. Among households that owned IRAs, the median account balance (\$50,000) was smaller than the average account balance (\$191,702), which indicates that some households likely had very large IRA account balances.
- Except for households in which the head of the household was 75 or older in 2013, the older that the head of the household was in 2013, the more likely the household was to have an IRA. Households that were 75 or older were more likely to have income from a traditional defined benefit pension plan and may not have had as great a need to establish an IRA or have a 401(k) account from which to make a rollover.<sup>22</sup>
- The percentage of households with an IRA and the median and average account balances increased with the income of the household. Among the explanations for this finding are that (1) households with more income are better able to save for retirement and (2) households with higher income are more likely to participate in a defined contribution (DC) plan (like a 401(k)) and therefore have an account to roll over.<sup>23</sup>
- Married households are more likely to have an IRA than single households and their median and average account balances are also larger.

**Table 7. Ownership and Account Balances for IRAs in 2013**

	Percentage of Households with Account	Median Account Balance	Average Account Balance
All Households	28.0%	\$50,000	\$191,702
Age of the Head of the Household:			
Younger than 35	13.8%	\$10,000	\$23,003
35 to 44	25.2%	\$25,000	\$73,173
45 to 54	28.1%	\$46,000	\$116,354
55 to 64	38.1%	\$70,000	\$224,426
65 to 74	40.9%	\$126,000	\$395,853
75 and Older	26.4%	\$70,000	\$228,620
Household Income:			
Less than \$30,000	6.6%	\$23,000	\$79,036

<sup>22</sup> In defined benefit (DB) pension plans, participants receive a monthly payment in retirement that is based on a formula that typically uses a combination of length of service, accrual rate, and average of final years' salary. For example, a plan might specify that retirees receive an amount equal to 1.5% of their pay for each year of service, where the pay is the average of a worker's highest five pay years. Over the past 30 years, the number of employers offering DB pension plans has declined, though many older workers were more likely to have a DB than a 401(k) plan. See *Figure 3. Percentage of Households in 2010 with an IRA Balance, DC Account Balance, or a Defined Benefit Pension*, in CRS Report R43057, *U.S. Household Savings for Retirement in 2010*.

<sup>23</sup> See CRS Report R43439, *Worker Participation in Employer-Sponsored Pensions: A Fact Sheet*.



	Percentage of Households with Account	Median Account Balance	Average Account Balance
\$30,000 to \$49,999	19.2%	\$26,500	\$77,434
\$50,000 to \$74,999	29.0%	\$45,000	\$130,533
\$75,000 to \$124,999	40.4%	\$50,000	\$182,329
\$125,000 or more	64.1%	\$200,000	\$690,515
Household Marital Status:			
Married	34.3%	\$114,000	\$527,171
Single	19.6%	\$48,000	\$160,789

**Source:** CRS analysis of the 2013 Survey of Consumer Finances.

**Note:** Median and average account balances are calculated among households that owned IRAs.

**Table 8** provides data on three types of IRAs: traditional, Roth, and rollover IRAs.

The following are key points regarding ownership of three types of IRAs in 2013:

- A larger percentage of households had traditional IRAs than had either Roth or rollover IRAs.
- With the exception of the median account for traditional IRAs in which the head of the household was aged 45 to 54, median and average account balances were higher for rollover IRAs than for either traditional or Roth IRAs. Funds contributed to rollover IRAs consist of defined contribution plan account balances (such as from a 401(k) plan) whereas traditional and Roth IRAs consist of accumulated contributions (which are limited to \$5,500 per year (\$6,500 for individuals 50 and older)).
- Among the age group classifications, ownership percentages for each of types of IRAs increased from the youngest age group (younger than 35) to the 55-to-64 age group. For the 65-to-74 age group, ownership percentages increased for traditional and rollover IRAs and decreased for Roth IRAs. For the three types of IRAs, ownership percentages decreased from the 65-to-74-year-old age group to the 75-and-older age group. With the exception of the oldest age group, median and average account balances also increased as the age of the head of the household increased for each of the three types of IRAs.
- Among the income group classifications, ownership percentages of each of the three types of IRAs increased as the household income increased. With the exception of the average rollover IRA account balance as household income increased from less than \$30,000 to \$30,000 to \$49,999, median and average account balances increased as household income increased.
- Married households were more likely to have any of the types of IRAs compared to single households. Married households also had higher median and average balances for each of the three types of IRAs.

**Table 8. Ownership and Account Balances for Traditional, Roth, and Rollover Individual Retirement Accounts (IRAs) in 2013**

	Traditional IRAs			Roth IRAs			Rollover IRAs		
	Percentage of Households with Account	Median Account Balance	Average Account Balance	Percentage of Households with Account	Median Account Balance	Average Account Balance	Percentage of Households with Account	Median Account Balance	Average Account Balance
All Households	14.9%	\$50,000	\$154,234	10.5%	\$20,000	\$67,966	10.2%	\$75,000	\$230,602
Age of the Head of the Household:									
Younger than 35	4.1%	\$10,000	\$20,763	8.3%	\$6,000	\$13,052	4.1%	\$9,800	\$30,122
35 to 44	9.3%	\$23,000	\$58,373	12.4%	\$16,000	\$46,873	8.5%	\$35,000	\$85,357
45 to 54	14.6%	\$40,000	\$79,157	12.1%	\$21,000	\$65,698	11.8%	\$38,000	\$112,026
55 to 64	22.4%	\$60,000	\$177,052	13.7%	\$30,000	\$73,944	14.0%	\$100,000	\$256,386
65 to 74	25.6%	\$80,000	\$290,562	10.7%	\$50,000	\$142,168	17.0%	\$157,000	\$424,939
75 and Older	19.9%	\$56,000	\$123,928	3.0%	\$50,000	\$156,134	6.8%	\$150,000	\$456,075
Household Income:									
Less than \$30,000	3.5%	\$15,000	\$42,327	1.7%	\$8,200	\$57,931	2.0%	\$46,000	\$129,538
\$30,000 to \$49,999	9.3%	\$35,000	\$72,689	6.7%	\$10,000	\$34,889	5.8%	\$48,000	\$96,636
\$50,000 to \$74,999	14.7%	\$50,000	\$114,994	9.8%	\$19,500	\$43,382	11.2%	\$51,500	\$142,397
\$75,000 to \$124,999	20.5%	\$56,000	\$164,530	16.9%	\$21,000	\$49,417	14.6%	\$65,000	\$209,887
\$125,000 or more	37.8%	\$122,500	\$392,466	25.7%	\$55,000	\$578,798	25.0%	\$252,000	\$650,003

	Traditional IRAs			Roth IRAs			Rollover IRAs		
	Percentage of Households with Account	Median Account Balance	Average Account Balance	Percentage of Households with Account	Median Account Balance	Average Account Balance	Percentage of Households with Account	Median Account Balance	Average Account Balance
Household Marital Status:									
Married	19.1%	\$90,000	\$321,030	13.3%	\$35,000	\$402,927	13.0%	\$134,000	\$499,037
Single	9.4%	\$40,000	\$140,040	6.8%	\$20,000	\$66,231	6.4%	\$78,000	\$211,516

**Source:** CRS analysis of the 2013 Survey of Consumer Finances.

**Note:** Median and average account balances are calculated among households that owned IRAs.

## **Appendix. Qualified Distributions Related to Natural Disasters**

As part of the response to the 2005 hurricanes that affected the communities on and near the Gulf of Mexico, Congress approved provisions that exempted individuals affected by the storms from the 10% early withdrawal penalty for withdrawals from IRA. In 2008, Congress approved similar provisions in response to the storms and flooding in certain Midwestern states. Following Hurricane Sandy in October 2013, the Internal Revenue Service (IRS) eased certain requirements for hardship distributions from defined contribution plans. The IRS was unable to exempt distributions from retirement plans from the 10% early withdrawal penalty because such an exemption requires congressional authorization.

### **Qualified Distributions Related to Hurricanes Katrina, Rita, and Wilma**

In response to Hurricanes Katrina, Rita, and Wilma, Congress approved the Gulf Opportunity Zone Act of 2005 (P.L. 109-135). The act amended the Internal Revenue Code to allow residents in areas affected by these storms who suffered economic losses to take penalty-free distributions up to \$100,000 from their retirement plans, including traditional and Roth IRAs. The distributions must have been received after August 24, 2005 (Katrina), September 22, 2005 (Rita), or October 22, 2005 (Wilma), and before January 1, 2007. The distributions are taxable income and can be reported as income either in the year received or over three years (e.g., a \$30,000 distribution made in May 2006, can be reported as \$10,000 of income in 2006, 2007, and 2008). Alternatively, part or all of the distribution may be repaid to the retirement plan within three years of receiving the distribution without being considered taxable income.

### **Qualified Distributions Related to the Midwestern Disaster Relief Area**

In response to severe storms, tornados, and flooding that occurred in certain Midwestern states, the Heartland Disaster Tax Relief Act of 2008 allows residents of specified Midwest areas to take penalty-free distributions up to \$100,000 from their retirement plans, including traditional and Roth IRAs. This act was passed as Division C of P.L. 110-343, the Emergency Economic Stabilization Act of 2008. The bill amends 26 U.S.C. 1400Q, which was enacted as part of the Gulf Opportunity Zone Act of 2005 (P.L. 109-135). The distributions must be received after the date in which the President declared an area to be a major disaster area and before January 1, 2010.<sup>24</sup> Apart from the dates and the areas affected, the provisions are identical to the provisions for individuals who were affected by Hurricanes Katrina, Rita, and Wilma.

### **Hurricane Sandy Relief**

No legislation was passed that would have (1) exempted individuals in areas affected by Hurricane Sandy from the 10% penalty for early withdrawals from IRAs or defined contribution

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<sup>24</sup> The disaster areas are limited to Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin.

retirement plans or (2) eased requirements for loans from defined contribution pensions for individuals affected by Hurricane Sandy in 2012.<sup>25</sup>

The IRS eased requirements for hardship distributions in areas affected by Hurricane Sandy. Among the relief offered by the IRS in Announcement 2012-44, “Plan administrators may rely upon representations from the employee or former employee as to the need for and amount of a hardship distribution” rather than require documentation from the employee of the need.<sup>26</sup> The relief offered by the IRS did not include an exemption from the 10% penalty for distributions before the age of 59½. Exemptions from the 10% penalty require congressional authorization. In addition, in the announcement, the IRS suspended the provision that requires an individual to suspend contributions to 401(K) and 403(b) plans for the six months following a hardship distribution.

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<sup>25</sup> H.R. 2137, the Hurricane Sandy Tax Relief Act of 2013, introduced by Representative Bill Pascrell on May 23, 2013, would have provided an exemption to the 10% early withdrawal penalty for retirement account distributions for those affected by Hurricane Sandy.

<sup>26</sup> See 26 CFR 1.401(k)-1.

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