

Practice Tips – IRA Distribution of Nondeductible Contributions

Summary	<p>Some IRA owners choose to maintain separate IRAs for their deductible and nondeductible Traditional IRA contributions, although the IRS does not require this be done. One of the reasons IRA owners maintain separate IRAs is for ease of tracking the separate types of contributions for distribution purposes. If the IRA owner maintains separate IRAs, he/she may want to consider combining the two IRAs into one.</p>
Client Profile	<p>-Traditional IRA owners eligible to make deductible and nondeductible (after-tax/basis) contributions</p> <p>-IRA owners who maintain separate IRAs for each type of contribution</p>
Apply the Rules	<p>Regardless of the number of Traditional IRAs an individual owns, in the IRS' eyes, all Traditional IRAs owned by an individual are aggregated and treated as one for distribution taxation purposes.</p> <p>Nondeductible Traditional IRA contributions are not taxed at the time of distribution.</p> <p>Traditional IRA owners who make nondeductible contributions must file IRS Form 8606 to report all contributions and distributions of nondeductible contributions.</p> <p>Traditional IRA distributions shall consist of a pro rata return of nondeductible and deductible contributions. The pro rata formula follows.</p> $\frac{\text{Aggregate nondeductible IRA contributions}}{\text{Aggregate IRA Balance}} \times \text{Distribution Amount} =$ <p>Nontaxable portion of distribution</p>
Ask key question(s)	<p>How do you calculate the nontaxable portion of a distribution?</p> <p>Is it more beneficial to maintain separate IRAs or combine them into one?</p>
Example	<p>Carrie's Traditional IRA balance at ABC Financial is \$200,000, and consists of \$56,000 of nondeductible contributions. She also has another IRA at XYZ Investments, in which she has \$3,000 of deductible contributions and her account balance in this IRA is \$8,000. Carrie has received a \$10,000 distribution from her IRA at ABC.</p> <p>What is the nontaxable portion of her distribution? $[(\\$56,000/\\$208,000) \times \\$10,000] = \\$2,692.31$</p>

Would it be more beneficial for Carrie to maintain the separate IRAs or combine them into one? Carrie has the option to set up separate IRAs for each type of contribution. However, regardless of the number of IRAs, the IRS treats them as one IRA for purposes of determining the nontaxable portion of a distribution.