ACTIVE PARTICIPATION AND IRA DEDUCTIBILITY

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This question (or a derivation of it) has been popular as of late: "*I only participated in my 401(k) for a couple of months in 2020 before I was laid off. Does that still make me a 'covered' employee, and can I contribute to my Traditional IRA?*"

It seems innocent enough, but there is a heck of lot going on in this little question.

Let's address the second part first: "*Can I contribute to my Traditional IRA?*" A person with earned income can always contribute to a Traditional IRA. It does not matter if you only had $25,000 of earned income, and it does not matter if you had $250,000 or more of earned income. The issue is whether or not the contribution to the Traditional IRA is deductible or not. In fact, the person with only $25,000 in earned income could possibly be restricted from taking the deduction, while the person who made $250,000 could potentially take a full deduction.

The deciding factor for deductibility is if you are an "active participant" (covered) by a retirement plan at work. If you have no retirement plan through your employer – no 401(k), no SEP, no SIMPLE, etc., - then you are not considered to be "covered." Your W-2 will usually provide this information. If you are not covered by a work plan, there should NOT be a check in the "retirement plan" box (Box 13) on that form. If there is no check, it does not matter what your income was – high, low, or somewhere in the middle. As long as you had earned income, you can make a Traditional IRA contribution and deduct it. (Be careful - sometimes employers mistakenly complete Box 13, so it is advisable to check with the employer if you are still unsure.)

On the other hand, if you were an active participant in a plan at work (the "retirement plan" box IS checked on your W-2), then you must now consider the phase-out ranges for Traditional IRA deductibility. You can certainly make the

Traditional IRA contribution, but you may not be able to deduct it. For 2020, the income phase-out ranges for Traditional IRA deductibility were $104,000 - $124,000 for those married/filing joint, and $65,000 - $75,000 for single filers. (In 2021, those numbers move to $105,000 - $125,000 and $66,000 - $76,000, respectively.)

So why might a person who only made $25,000 be restricted from deducting his Traditional IRA contribution? If he was married/filing joint and the combined income for the couple was too high, he could be phased out. Note that there is another phase-out range when one spouse is covered by a work plan and the other is not. The covered spouse uses the married/filing joint phase-out ranges listed above. The uncovered spouse is allowed a higher phase-out range ($196,000 - $206,000 for 2020; $198,000 - $208,000 for 2021).

As for the first part of the initial question above ["*I only participated in my 401(k) for a couple of months in 2020 before I was laid off*"], there is no benefit for minimal participation in a work plan. You either were a participant or you were not. True/False. Yes/No. Minimal participation is enough to make a person an active participant. A person who is an active participant for any part of the year is deemed to be an active participant for the entire year.

Be aware that a Traditional IRA contribution is always permitted for those with earned income. It is the deductibility of that Traditional IRA contribution that is the question. Work plan coverage and income levels must be considered to determine deductibility.