



An IRA Refresher

The almost-annual changes to the income tax laws have created confusion about Individual Retirement Accounts (IRAs). This confusion has caused many people to ignore one of the most powerful tools available to help them secure a solid financial future.

Even with all the changes, IRAs can and should be a key part of the foundation of most people's retirement planning efforts. Here are some of the facts you should know to make fully informed IRA decisions:

- The annual contribution limit for 2010 is \$5,000. In subsequent years, the limit will be adjusted annually for inflation in \$500 increments. The only requirement is that you have at least that much income from wages or salaries.
- Individuals ages 50 and older are able to make additional catch-up contributions. The limit for these additional contributions is \$1,000.
- Your contribution to a "regular IRA" is tax-deductible if you are not a participant in your employer's qualified retirement plan. If you are a participant in a qualified retirement plan, the deductibility of contributions to regular IRAs is determined by your modified adjusted gross income (MAGI). For married couples filing a joint return in 2010, the deduction is phased out at MAGI levels between \$89,000 and \$109,000.
- Earnings on funds within an IRA are not subject to income tax as they are earned. Tax deferral allows for the funds to accumulate faster. With a "regular IRA", earnings are taxed when withdrawn from the IRA.
- IRAs were established to be long-term retirement planning accounts. As such, the IRS imposes a penalty tax of an additional 10% if funds are distributed before reaching age 59 ½. There are a few exceptions to this rule, including a first time home purchase.
- If you have established IRAs at different institutions over the years, you can consolidate them into one account to make it easier to keep track of your funds. If done properly, there are no income tax consequences to this consolidation.
- IRAs can serve as the account to receive a distribution from your employer's qualified plan when you change employers or retire. Tax deferral is maintained and you may have additional investment flexibility.
- You must begin taking distributions from a regular IRA at age 70 ½. However, for 2009 only, there is no minimum distribution requirement.

Roth IRAs

A few years ago, a new type of IRA was created that has become an attractive alternative to the "regular IRA." This new "Roth IRA" (named after the Delaware senator) has the same annual contribution limits (\$5,000 for 2008) and the same tax deferral benefits on earnings within the IRA. Similar to regular IRAs, catch-up contributions are allowed.

The biggest differences are that the contributions are not tax deductible and that distributions are not subject to income tax. The other difference is that Roth IRA contributions are not allowed if your modified adjusted gross income exceeds certain levels. For single filers in 2010, full contributions are allowed if your MAGI is less than \$105,000, partial contributions are allowed if your AGI is between \$105,000 and \$120,000 and no contributions are allowed if your AGI is above \$120,000. For married couples filing joint returns, full contributions are allowed if your AGI is below \$167,000, partial contributions if your AGI is between \$167,000 and \$177,000 and no contributions are allowed if your MAGI is over \$177,000.

When comparing regular and Roth IRAs, the trade-off is usually whether the loss of deductibility on current contributions with a regular IRA is worth the benefit of never having to pay income tax on distributions from a Roth IRA. Roth IRAs also provide more distribution flexibility. For many, the Roth IRA can result in superior long-term benefits.

Some General Guidelines

- If you can afford it, contributions to both an IRA and a 401(k) plan can help you accumulate funds faster. If you can only do one, the 401(k) should probably be chosen because of possible employer matches and deductibility of contributions.
- The value of the tax deferral on earnings within a regular IRA increases the longer the funds are in the IRA.
- Non-deductible contributions to a Roth IRA should be considered carefully in lieu of deductible contributions to a regular IRA.
- Special rules cover the conversion of regular IRAs to Roth IRAs. The advantages can be large but there will be a current tax liability. Be sure to consult with a qualified advisor for an evaluation.