Retirement Planning with IRAs

Maybe you participate in an employer's retirement savings plan. Maybe not. Either way, an individual retirement account (IRA) can play an important role in your retirement planning.

An IRA offers you a flexible and tax-advantaged opportunity to invest for your future financial needs. During your working years, you may contribute every year, but you aren't *required* to do so. In addition to your annual contributions, an IRA can receive rollover contributions from other retirement plans, allowing you to streamline the management of your retirement assets.

There are two basic types of IRAs: traditional and Roth. Each has specific tax advantages and requirements that you'll want to become familiar with before investing.

Lower Your Current Taxes with a Traditional IRA

Your annual contributions to a traditional IRA will be tax deductible if you meet certain tax law requirements. As an added benefit, IRA investment earnings are tax deferred. The combination of these tax advantages allows you to accumulate more in a deductible IRA than you could by investing on an after-tax basis in a comparable taxable account.

For your IRA contributions to be deductible, you must meet one of the following conditions:

- Neither you nor your spouse can be an active participant in an employer-sponsored plan, or
- If you (and/or your spouse) actively participate in an employer's plan, your adjusted gross income (AGI) must be below a certain level.

If you wish to, you may contribute to a traditional IRA even if you don't qualify for deductible contributions. With a nondeductible IRA, you still receive the benefit of tax deferral on your investment earnings. However, before you make nondeductible contributions to a traditional IRA, you may want to see whether you're eligible to contribute to a Roth IRA.

So far, you've read about the tax treatment of traditional IRA contributions and earnings. What about account withdrawals? They're subject to income taxes at ordinary rates. The exception: Amounts attributable to nondeductible contributions are returned to you tax free.

Enjoy Tax-free Withdrawals with a Roth IRA

Unlike traditional IRA contributions, Roth IRA contributions are always made on an after-tax basis—that is, you may not deduct your contributions to a Roth IRA. As with a traditional IRA, Roth IRA investment earnings are tax deferred. However, withdrawals from a Roth IRA are *tax free* if you meet certain requirements. This means that the earnings are *never* subject to income tax.

To gain this special tax treatment, funds must remain in your Roth IRA for a five-year period. This period begins with the first taxable year for which you make a contribution. After that, earnings may be distributed from your Roth IRA tax free:

- Once you have reached age 59½
- To your beneficiaries after your death
- If you become disabled
- In order to pay qualified first-time homebuying expenses of up to $10,000 (lifetime limit)

Withdrawals of original Roth IRA *contributions* are not subject to any tax-related restrictions. However, the ability to contribute to a Roth IRA is limited for higher income individuals.

Receiving Distributions from an IRA

If you withdraw money from a traditional IRA before age 59½, you may be subject to a 10% penalty tax in addition to ordinary income tax. Some early withdrawals are not subject to the penalty, however. These include distributions made due to disability, for certain medical expenses, or for qualified homebuying or higher education costs.

Converting a Traditional IRA into a Roth IRA

You may roll over a traditional IRA into a Roth IRA if you feel a Roth IRA would better suit your planning needs. However, any taxable amounts that are rolled over generally must be included in your income in the tax year in which the rollover occurs.

Traditional or Roth. The choice is yours. Either type of IRA can help you reach your retirement goals.

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