

Maximizing
Individual Retirement
Accounts

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*Getting the most
from your IRA*

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Individual Retirement Accounts (IRAs) can assist most of us in attaining our long range financial goals for retirement. They serve as key planning vehicles because of their preferred treatment in the tax code. In some cases, your contributions into an IRA and the earnings are not taxed until withdrawn at retirement. In other cases your earnings within an IRA are tax free. This brochure discusses your many IRA options to help you maximize your retirement savings.

Since the 1997 Tax Relief Act you can choose from a Traditional IRA, a Roth IRA or both. Plus you can open a Coverdell Education savings account which provides tax benefits for taxpayers, with future educational expense needs.

Each of these IRAs offers different tax advantages to different taxpayers, but all of them allow favorable tax treatments on earnings to accelerate compounded growth of your savings.

TYPES OF IRAS

Traditional IRAs

Traditional IRAs are the cornerstone of individual retirement accounts. The contributions and earnings are not taxed at time of deposit, but only at time of withdrawal. If your annual

income is too high, your contributions may be taxed, but the earnings compound on a tax deferred basis. Other specifics include:

- The annual contribution is limited per person.
 - The contribution deadline is April 15th of the following tax year.
 - Contributions are tax deductible for anyone not covered in an employer plan regardless of income level but even for those covered in employer plans if your income is below certain thresholds.
 - Earnings are tax deferred.
 - Withdrawn funds are taxed as ordinary income.
 - Withdrawals before age 59½ are subject to a 10% penalty unless the withdrawal is for medical expenses, medical insurance if unemployed, post secondary education expenses, a first home purchase (\$10,000 lifetime limit), disability or death (any ordinary income tax would still be owed).
- Hint:** Penalty free withdrawals may be made before age 59½ if they are made in substantially equal sums for the longer of five years or until the age 59½. But be careful, the withdrawal rules are complex and if not followed you may be subject to the penalty.
- Withdrawals of non-deductible contributions are tax free.
 - Contributions must cease at age 70½ and annual distributions are mandatory at age 70½ based on life expectancy.

Roth IRAs

The Roth IRA allows you to deposit funds after paying the tax and the earnings ARE NOT TAXED at the time of withdrawal.

The basics of the Roth IRAs are:

- Contributions are after-tax and non-deductible.
- There is an annual contribution limit.
- Contribution eligibility is phased out as income rises from \$95,000 to \$110,000 for single taxpayers and \$150,000 to \$160,000 if married.
- Contribution deadline is April 15th of the following year.
- Contributions may continue after 70½.
- Withdrawals are tax free if withdrawn after age 59½ and if after at least five years from your beginning contribution date.
- Withdrawals prior to the five year period will be taxed.
- Non-qualified withdrawals before age 59½ will be taxed and any taxable portions will be assessed a 10% penalty.
- Early withdrawals after five years but before age 59½ will be taxed but are not subject to the 10% tax penalty if the withdrawal is for a first home purchase (up to \$10,000), disability, death, post secondary education, medical expenses and insurance of unemployed.

An IRA Comparison

Features	Traditional IRA	Roth IRA	Coverdell ESA (Education Savings Account)
Year	2005-2006	2005-2006	2005-2006
Annual Contribution	\$4,000 per person (\$4,500 if 50 or older)	\$4,000 per person (\$4,500 if 50 or older)	\$2,000 per student
AGI Phase out*	\$50-60,000-single } \$70-80,000-married } 2005 income plus: \$5,000 for 2006	\$95-110,000-single; \$150-160,000-married	\$95-110,000-single; \$190-220,000-married
Contribution Deductibility	Yes	No	No
Contribution Deadline	April 15th following year	April 15th following year	April 15th the following year
Contributions Timing	Must cease at 70½	Can contribute indefinitely	Cease if student age 30
Earnings	Grow tax deferred	Grow tax free if held five years	Grow tax free
Withdrawals	Taxed as ordinary income if over 59½	Tax free if over 5 years and 59½	Tax free if for education
Withdrawal Penalty	10% under 59½ unless for medical, medical insurance if unemployed, higher education, first home up to \$10,000, disability or death	10% and earnings are taxed if under 59½ unless for first home up to \$10,000, disability or death; withdrawals are considered contributions first, taxable earnings second	10% penalty and earnings taxed if not used for qualified education expenses or if after student's 30th birthday
Distributions	Mandatory At 70½	Non-mandatory	Mandatory within 30 days of turning 30 (unless special needs)
Roll Over	Yes into another IRA; taxed into a Roth IRA; penalty if income over \$100,000	IRAs, SEPs and SIMPLEs may be rolled into a Roth; Keoghs and 401(k)s	May be rolled over to another student's Coverdell IRA or same student's IRA

*AGI phase-outs only apply to those also enrolled in an employer-provided retirement plan such as a 401(k). If not in such a plan, you may make the annual deductible contribution to a traditional IRA at any income level provided your income is not lower than the contribution.

- Early withdrawals are taxed on the earnings but not the contributions which were made with after-tax dollars.

Coverdell ESA (formerly Education IRA)

From 1998 through 2001, you were permitted to make non-deductible annual contributions of \$500 into Education IRAs for students under 18. Effective in 2002 and beyond:

- The Education IRA has been renamed to Coverdell Education Spending Account (ESA).
- The annual contribution is now \$2,000.
- The student/beneficiary must be under age 30.
- Contributions are not deductible from income but withdrawals (including earnings) are Federal income tax free if used for qualified education expenses.
- Eligibility to contribute has income phase outs of \$95,000 to \$110,000 for singles and \$190,000 to \$220,000 for joint filers.
- Qualified tax free withdrawals include education expenses for tuition, books, fees, supplies, equipment and room and board. Room and board expenses do not qualify if the student is enrolled for less than half time.
- Unqualified distributions are taxed and a 10% penalty is applied unless withdrawn due to death, disability, or in equal magnitude to a scholarship or other educational assistance.
- Unused amounts must be withdrawn within 30 days of the student turning age 30 and will be taxed as ordinary income and assessed a 10% penalty.

Tip: Any unused amounts may be rolled over tax free into a regular IRA for the student or into another Coverdell ESA for the education expenses of any of the student's family members.

Caution: Coordination with other education benefits is important. You must reduce qualified expenses by scholarships, fellowships, grants, and other tax free educational benefits.

WHICH RETIREMENT IRA IS BETTER?

Choosing a Traditional IRA or Roth IRA

- ✓ If you are eligible for a deductible contribution to a regular IRA or a contribution to a Roth IRA, you are

generally better off with the Roth IRA. Key considerations are your tax brackets when you contribute and when you withdraw, how old you are and how long you expect to keep the funds in the account.

- ✓ There's more flexibility with a Roth IRA since mandatory withdrawals after age 70½ are not required and you can continue to make contributions as long as you like.
- ✓ If your income is too high for a deductible contribution to a regular IRA or a non-deductible contribution to a Roth, consider making a non-deductible contribution to a regular IRA for the tax deferred benefits on the earnings growth.

Tip: If you have the option of investing in an IRA or a 401(k), you will generally do better to first maximize your contribution to an employer sponsored 401(k) plan in which the employer matches a portion of your contribution.

- ✓ Roll overs from deductible or non-deductible IRAs, SEPs or SIMPLEs into a Roth IRA are allowed without the early withdrawal 10% penalty provided your income is \$100,000 or less and you are not married and filing separately. Regular income tax is due on any taxable rollover amounts.

Tip: Taxpayers with non-deductible IRAs should consider rolling over amounts into Roth IRAs. While the past earnings are now taxed at time of rollover, future earnings are tax-free.

TAX RELIEF RETIREMENT INCENTIVES

There was an emphasis on encouraging Americans to save for retirement in recent Tax Relief Bills. The Bills do three things:

1. Increase amounts one may save annually in the respective IRA accounts.
2. Increase the income limits for participation in the plans.
3. Motivate people 50 and older with an additional \$500 contribution option thru 2005 (\$1,000 - 2006 & beyond).

Special Savings Incentive

In addition to being allowed to reduce your gross income for deposits in an IRA there is an added incentive to save for retirement. It's called the Retirement Contribution Credit. During the tax years 2002 thru 2006 an additional tax credit of up to \$1,000 will be available to taxpayers with income less than \$50,000 for joint filers (\$25,000 for single; \$37,500 for head of household).

This publication provides only summary information regarding the subject matter. Please call with any questions on how this information may impact your situation.