Individual Retirement Accounts: Three Ways to Save

You're probably familiar with Individual Retirement Accounts, popularly known as "IRAs." But did you know that recent tax law changes have created three different types of IRAs? Today you can choose from the Traditional IRA, Non-Deductible IRA, or Roth IRA - each of which offers unique benefits and advantages.

Traditional IRA

The granddaddy of them all, a traditional IRA allows individuals under the age of 70-1/2 with earned income to contribute as much as $4,000 of compensation in 2006 and 2007 (the limit rises to $5,000 in 2008). In addition, taxpayers aged 50 and older can now make "catch up" contributions of an additional $1,000 in the 2006 and 2007 tax years. Contributions and earnings generally grow tax-deferred until qualified withdrawals begin at age 59-1/2 - a powerful benefit that helps IRA owners pursue retirement and other important financial goals.

Married couples that file jointly may contribute up to $8,000 ($4,000 per IRA) each year even if only one spouse has earned income (certain limitations apply).Best of all, your IRA contributions may be tax deductible depending on your participation in an employer-sponsored retirement plan such as a 401(k), your adjusted gross income (AGI), and your filing status. Non-qualified withdrawals are subject to ordinary income tax as well as a 10% federal penalty. Certain exceptions apply, including unreimbursed medical expenses, education expenses, and first-time home ownership.

Non-Deductible IRA

The non-deductible IRA is similar to the traditional IRA except that contributions are made with after-tax dollars and the income tax deduction allowed for traditional IRAs does not apply. This type of IRA is generally used by individuals who do not qualify for a traditional IRA but want the benefits of tax-deferred compounding that IRAs offer. As with the traditional IRA, contribution limits are limited to the lesser of total earned income or $4,000 in 2006 and 2007, plus the $1,000 catch-up provision for those age 50 or higher in 2006 and 2007.

Roth IRA

First introduced in 1998, the Roth IRA offers owners a powerful advantage: tax-free distributions. Contribution limits are the same as the previous two types of IRAs, and the earned-income and catch-up provisions both apply. Qualified withdrawals of both contributions and earnings are free from federal income tax. Since contributions are made with after-tax dollars, they can be withdrawn tax-free at any time. As with traditional and non-deductible IRAs, early withdrawals may be subject to federal income tax plus a 10% federal penalty. Also, eligibility to contribute to a Roth IRA begins phasing out for individuals and households with a modified AGI of $95,000 and $150,000, respectively, and those with modified AGIs exceeding $110,000 (individuals) and $160,000 (households) cannot open or contribute to a Roth IRA.

Which is Right for You?

The answer to that question depends on a number of factors, including your age, household AGI, current and projected tax rates, whether or not you are eligible to participate in an employer-sponsored retirement plan, your marital status, and your retirement goals. We'd be happy to discuss your options and help you make the right choice based on your individual needs.