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Roth IRAs

LEBEL & HARRIMAN LLP

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Roth IRAs

Definition

A Roth individual retirement account (IRA) is a personal savings plan that offers tax benefits to encourage retirement savings. You can contribute up to the lesser of $5,000 in 2008 and 2009, or 100 percent of your taxable compensation to a Roth IRA. In addition, individuals age 50 or older can make an extra "catch-up" contribution of up to $1,000 in 2008 and 2009. Contributions to a Roth IRA are not tax deductible, but the funds grow tax deferred and distributions are tax free under certain conditions.

Prerequisites

- You have taxable compensation (i.e., wages, self-employment income) during the year of the contribution
- Your modified adjusted gross income (MAGI) for 2009 must be:$105,000 or less for a full contribution if your tax filing status is single or head of household (partial contribution allowed, up to MAGI of $120,000)
- $166,000 or less for a full contribution if your tax filing status is married filing jointly or qualifying widow(er) (partial contribution allowed, up to MAGI of $176,000)
- $10,000 or less for a partial contribution if your tax filing status is married filing separately and you lived with your spouse at any time during the year (full contribution not allowed)
- Note: These income ranges are for the 2009 tax year, and are indexed for inflation.

Key Strengths

- Qualified distributions are completely tax free (and penalty free)
- You can contribute after age 70½ (as long as you have taxable compensation)
- You have flexibility in withdrawing your funds prior to retirement
- You are not required to take any distributions while you are alive
- Contributions can be made even if you are covered by an employer-sponsored retirement plan
- IRAs offer a wide range of investment choices
- $1,095,000 (as of 4/1/07) (and in some cases more) of IRA assets are protected in the event of bankruptcy under federal law

Key Tradeoffs

- You receive no tax deduction when you make a contribution
- If a withdrawal does not qualify for tax-free status, the portion that represents earnings is subject to federal income tax (and perhaps an early withdrawal penalty if under age 59½)
- Special penalty provisions may apply to withdrawals of Roth IRA funds that were converted or rolled over from a traditional IRA, SEP IRA, or SIMPLE IRA

- There is always the possibility that the law will change in the future

Variations from State to State

- States vary in their protection of Roth IRAs from creditors
- States may differ in their tax treatment of Roth IRAs

How Is It Implemented?

- Open a Roth IRA with a bank, financial institution, mutual fund company, life insurance company, or stockbroker
- Select types of investments to fund the Roth IRA (e.g., CDs, mutual funds, annuities)
- Make contributions up to the due date of your federal income tax return for that year (usually April 15 of the following year), not including extensions

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