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Traditional IRAs

Lebel & Harriman LLP

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Traditional IRAs

Definition

A traditional individual retirement account or individual retirement annuity (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 traditional IRA. In addition, individuals age 50 and older can make an extra "catch-up" contribution of $1,000 in 2008 and 2009. Funds in a traditional IRA grow tax deferred until they are withdrawn. Contributions may be fully or partially tax deductible, depending on certain factors.

Prerequisites

- You have not reached age 70½ during the year of the contribution
- You have taxable compensation (i.e., wages, self-employment income) during the year
- You can deduct the full amount of your contribution provided that you are not covered by an employer-sponsored retirement plan
- If you are covered by an employer-sponsored retirement plan, your IRA deduction (if any) depends on your modified adjusted gross income (MAGI) and your federal income tax filing status. You will be entitled to a partial deduction in 2009 if your MAGI is less than:$65,000 if your filing status is single or head of household (less than or equal to $55,000 for a full deduction)
- $109,000 if your filing status is married filing jointly (less than or equal to $89,000 for a full deduction)
- $10,000 if your filing status is married filing separately (full deduction not available)

Note: These income ranges are for the 2009 tax year, and are indexed for inflation.

Key Strengths

- Deductible contributions are made on a pretax basis
- Funds in traditional IRAs grow tax deferred until they are withdrawn
- 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

- Your ability to deduct contributions may be reduced or eliminated if you are covered by an employer-sponsored retirement plan.
- Funds you withdraw from a traditional IRA are taxable income in the year received (to the extent that the withdrawal consists of deductible contributions and investment earnings).
- Withdrawals taken before age 59½ may be subject to a 10 percent premature distribution tax (subject to certain exceptions).
- Minimum annual withdrawals are required when you reach age 70½ (required minimum distributions).

See disclaimer on final page

(Note: The Worker, Retiree and Employer Recovery Act of 2008 waives required minimum distributions for the 2009 calendar year.)

- Taxable portion of distributions will be taxed at ordinary income rates even if funds represent long-term capital gains or dividends paid on stock held within the IRA.

Variations from State to State

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

How Is It Implemented?

- Open an IRA with a bank, financial institution, mutual fund company, life insurance company, or stockbroker
- Select types of investments to fund the 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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