QUANTUM FINANCIAL PLANNING SERVICES, INC.

THE DIFFERENT KINDS OF IRAs

There are many varieties of this popular savings vehicle.

What don't you know? Many Americans know about Roth and traditional IRAs … but there are also many other types of IRAs. Here's a quick look at several basic classes of IRAs, as well as some variations and additional information.

Traditional IRA.
(2008/2009 contribution limit of $5,000, $6,000 if you are 50 or older)[1]
A traditional IRA (or deductible IRA) is an individual savings plan for anyone who receives taxable compensation. IRA assets may be invested in any number of vehicles, and contributions may be tax-deductible. Earnings in a traditional IRA grow tax-deferred until withdrawal, but they will be taxed when withdrawal begins - and withdrawals must begin by the time the IRA owner reaches age 70½. If these Required Minimum Distributions (RMDs) are not taken at that age, a 50% penalty will be assessed on the amount not distributed. You cannot contribute to a traditional IRA after age 70½. The IRS considers all IRAs other than Roth and SIMPLE IRAs as traditional IRAs.[2]

Roth IRA.
(2008/2009 contribution limit of $5,000, $6,000 if you are 50 or older)[1]
A Roth IRA offers you a) tax-free compounding, b) tax-free withdrawals if you are older than age 59½ and have owned your account for at least five years, c) the potential to make contributions to your IRA after age 70½ without having to take RMDs. While contributions to a Roth IRA are not tax-deductible, a Roth IRA has an advantage on the back end, with fewer requirements and limitations regarding withdrawals.[3,4]

In 2010, anyone with a traditional IRA may convert it to a Roth IRA. Before 2010, you have to meet an eligibility test to do that: your modified adjusted gross income (MAGI) must be less than $100,000 in the year you convert the IRA, not counting the income that would result from the conversion.[5]

SIMPLE IRA.
(Contribution limit of $10,500 for 2008, $11,500 for 2009;
$2,500 catch-up contribution allowed if you are 50 or older)[6]
SIMPLE IRAs are qualified retirement plans for businesses with 100 or fewer employees. They are much easier (and more affordable) to administrate than 401(k) or 403(b) plans. They are funded by "elective deferrals" (salary reduction contributions from employees), and generally the employer has to match employee contributions on a dollar-for-dollar basis up to 3% of an employee's compensation.[6]

SEP.
(Contributions cannot exceed $46,000 for 2008, $49,000 for 2009, or a maximum of 25% of employee compensation)[7]
SEP stands for Simplified Employee Pension. These traditional IRAs are set up by an employer for employees, and like a pension plan, funded by employer contributions only. Contributions are tax-deductible, but qualified withdrawals taken after age 59½ are taxed at standard income tax rates. If an employer implements an SEP plan, allocations to all employees' SEP-IRAs must be proportional to their salary/wages.[7]

Individual Retirement Annuity.
(Standard traditional or Roth IRA contribution limits)[8]
Some annuity contracts allow you to set up a traditional or Roth IRA with a life insurance company. Payments to the annuity may be made by the annuity owner or another party. The annuity owner's entire interest must be fully vested, and the owner cannot transfer any of the balance to someone else.[8]

Spousal IRA.
(2008/2009 contribution limit of $5,000, $6,000 if you are 50 or older)[9]
This is actually a rule that lets a working spouse make traditional or Roth IRA contributions on behalf of a non-working or retired spouse. The working spouse's income is the determining factor as to whether or not a "Spousal IRA" contribution can be made. Contribution limits and eligibility requirements are the same as those for a regular IRA.

Inherited IRA.
(No contributions allowed in some cases)
A Roth or traditional IRA inherited by a non-spousal beneficiary. You cannot treat this IRA as your own. (If you inherit your spouse's IRA, you can name yourself as the new owner and sole beneficiary and make contributions and withdrawals from it.) Distributions from inherited IRAs are subject to the minimum distribution rules; they must be taken over your lifetime, and the inherited IRA assets cannot be rolled over into an IRA you own.[10] Inherited traditional IRAs may not be converted into Roth IRAs, but thanks to IRS Notice 2008-30, non-spouse beneficiaries of company retirement plan assets may now convert those inherited assets into Roth IRAs.[11]

Group IRA.
(2008/2009 contribution limit of $5,000, $6,000 if you are 50 or older)[1]
These retirement trusts are created by employers, unions, and other employee associations to provide traditional IRAs for workers and members.

Rollover IRA.
(2008/2009 contribution limit of $5,000, $6,000 if you are 50 or older)[1]
Assets distributed from a qualified retirement plan may be rolled over into a traditional IRA, which may be converted later to a Roth IRA. Assets can be commingled within the IRA and rolled into another employer plan in the future.[12]

Education IRA (Coverdell ESA).
(2008/2009 contribution limit of $2,000)[13]
A way for middle-class investors to save for a child's education. Parents and guardians can make nondeductible contributions totaling up to $2,000 annually into this IRA on behalf of a minor. You get tax-free growth and tax-free withdrawals, provided the money is used for education expenses. Money from a Coverdell ESA must be distributed to the beneficiary before age 30 (unless he or she has special needs). single filers must have a modified adjusted gross income (MAGI) of $95,000 or less, and joint filers must have a MAGI of $190,000 or less. Coverdell ESAs face a sunset provision in 2010: if no Congressional action is taken, yearly contribution limits will only be $500 starting in 2011.[13]

The bottom line. You should consult a qualified financial advisor regarding your IRA options. There are many choices available, and it is vital that you understand how your choice could affect your financial situation. No one IRA is the "right" IRA for everyone, so do your homework and seek advice before you proceed.

Houston E. Scrudder, CFP®, John A. Nord, CFP®, John James, CFP®, CDFA™, and C. Eric Christiansen, CFP®, are representatives with Securities Services Network and may be reached at www.quantumplanning.com, 509-328-6653, or QuantumTeam@QuantumPlanning.com.

Citations.

[1] chicagotribune.com/business/yourmoney/chi-ym-journey-1116nov16,0,4663662.story [11/16/08]
[2] irs.gov/publications/p590/ch01.html#d0e8323 [11/19/08]
[3] fool.com/Money/AllAboutIRAs/allaboutiras03.htm [11/19/08]
[4] irs.gov/publications/p590/ch02.html#d0e9236 [11/19/08]
[5] filife.com/stories/preparing-for-a-roth-ira-conversion-in-2010 [1/30/08]
[6] irs.gov/retirement/article/0,,id=111420,00.html#4 [11/19/08]
[7] irs.gov/retirement/article/0,,id=111419,00.html [11/19/08]
[8] investopedia.com/terms/i/individual_retirement_annuity.asp [11/19/08]
[9] investopedia.com/terms/s/spousalira.asp [11/19/08]
[10] usatoday.com/money/perfi/taxes/2007-04-13-aicpa13-saks_N.htm [4/13/07]
[11] irahelp.com/newsletter/files/0088-2008-APR%20(1).pdf [4/08]
[12] fool.com/Money/AllAboutIRAs/allaboutiras02.htm [11/18/08]
[13] 360financialliteracy.org/Life+Stages/College/Articles/Paying+for+College/The+best+ways+to+save+for+college.htm [11/18/08]