

Roth IRA

Answers

To Your

Questions

A wealth of information to plan your future

The Roth IRA offers unique and exciting savings opportunities. Not only can it help with retirement needs, but also a first-time home purchase or other financial goals. This flexibility makes the Roth IRA appealing to many different age and income groups. Although it's not a one-size-fits-all solution, the Roth IRA will give many members an easy and safe way to plan for the future.

Is the Roth IRA for you? Hopefully, this brochure will help you decide.

We have compiled answers to the most commonly asked questions in order to give you a better understanding of the Roth IRA, which is available right here at your credit union. We hope that this information will be valuable when you evaluate your savings options.

Of course, it's important to get all the details before you make your decisions. We are here to help answer your Roth IRA questions.

Q. What is the Roth IRA?

A. The Roth IRA is an individual retirement account created by the Taxpayer Relief Act of 1997. Named for former Senate Finance Committee Chairman William Roth, Jr., this IRA offers more incentives to boost your retirement savings, as well as more ways to use your nest egg.

Q. How does the Roth IRA work?

A. Unlike traditional IRAs, your contributions to a Roth IRA are never tax-deductible. However, the money in your Roth IRA, including earnings, can be withdrawn tax-free. Of course, you must conform to the plan provisions to get this tax-free advantage.

Q. Am I eligible to contribute to a Roth IRA?

A. You are eligible if you earn compensation and your income is less than limits set by Congress. A single filer who has modified adjusted gross income (MAGI) up to \$95,000 can make the full Roth IRA contributions for that year. Each spouse filing a joint federal income tax return showing a MAGI up to \$150,000 can make the full Roth IRA contributions for that year. Some people with higher MAGI may be able to make smaller contributions.

Q. How much is the full Roth IRA contribution?

A. The amount of a full Roth IRA contribution varies. If you meet the eligibility tests described above and you are under age 50, you can contribute up to \$3,000 for 2002 through 2004. If you have attained age 50 by the end of a year, then your limits are \$3,500 for 2002 through 2004. These limits are even higher for later years.

Q. What happens if my (our) income is too high to make a full contribution to a Roth IRA?

- A.** A smaller contribution can be made if your MAGI is between \$95,000 and \$110,000 for single filers, and between \$150,000 and \$160,000 for joint filers. When income exceeds \$110,000 for single filers and \$160,000 for joint filers, a regular Roth IRA contribution can't be made for that year.

Q. Can I get any tax credits for making IRA contributions?

- A.** You may be able to receive a tax credit for making contributions for the 2002 through 2006 tax years. The full credit is 50 percent of the first \$2,000 of contributions. The full credit is available for joint filers who have joint MAGI up to \$30,000, heads of households with MAGI up to \$22,500, or other filers with MAGI up to \$15,000. Smaller tax credits are available for joint filers with MAGI up to \$50,000, heads of households with MAGI up to \$37,500, or other filers with MAGI up to \$25,000.

Q. Can I still contribute to a Roth IRA if I participate in an employer-sponsored retirement plan?

- A.** Yes, and you can contribute past age 70½ as long as you continue to earn compensation.

Q. Will my Roth IRA affect the amount that I can contribute to my employer-sponsored retirement plan?

- A.** No. The amount you contribute to your 401(k) or other employer-sponsored plans will not be

affected by your Roth IRA. However, you must conform to the plan contribution limits for your employer-sponsored plan.

Q. Can I have both a traditional and a Roth IRA?

- A.** Yes, you can maintain both types of IRAs at the same time. You can even make contributions to both types of IRAs in the same year. But your contributions to both Roth and traditional IRAs cannot exceed the maximum contribution limit for all IRAs.

Q. When can I start taking tax-free distributions from my Roth IRA?

- A.** You can withdraw most contributions without paying income tax at any time. Distributions are treated as first being attributable to your contributions until all of your contributions have been distributed.

There are two requirements to qualify for tax-free withdrawals of the income your Roth IRA has earned. First, your Roth IRA must meet the “five-year test.” In other words, it must be five years after the first year for which Roth contributions were made. Second, one of the following conditions must apply:

- (a) You are over age 59½
- (b) Funds are going to your beneficiary upon your death
- (c) You have become disabled
- (d) You are using the funds for a first-time home purchase (lifetime limit is \$10,000 per person)

If you have made a conversion contribution, please read further for taxation issues regarding conversions in this situation.

Q. What if I make an early withdrawal from my Roth IRA and I am not age 59½ or covered by any exceptions?

A. Good news. If you make early withdrawals from a Roth IRA to which you have only made regular contributions within the maximum annual limits, the amounts are considered to come from your already-taxed contributions first, with no additional taxes or penalties due. When you begin to withdraw earnings from the account, this money will be subject to ordinary income taxes, plus an additional ten percent early distribution tax.

Q. Do I have to take minimum distributions when I reach age 70½?

A. No. The Roth IRA is more flexible than a traditional IRA because you are not required to start taking minimum distributions when you reach age 70½. If you don't need the cash, you can let your money continue to grow tax-free for as long as you like. However, minimum distributions must be made to your beneficiaries following your death.

Q. Can I convert my existing traditional IRA to a Roth IRA?

A. Yes. You can convert your traditional IRA to a Roth IRA if your MAGI in the year of the conversion is under \$100,000. This limit is the same for both single filers and married couples who file jointly. Married taxpayers who file separately are not eligible for a Roth conversion. Use care and be sure to get all the facts. This is a complicated decision.

Q. Does the IRA conversion contribution ceiling of \$100,000 MAGI include the IRA conversion amount?

A. No, the MAGI is calculated prior to adding the amount of the IRA conversion contribution.

Q. If I convert a traditional IRA to a Roth IRA, do I owe any taxes?

A. Yes. Upon conversion, you will owe ordinary income taxes on your investment earnings and on deductible contributions you have made to your traditional IRA. This amount is taxable income in the year the money leaves the traditional IRA. Basically, you owe tax on any money that has not been taxed before. But you will have the opportunity to withdraw earnings made after the conversion, free of any taxes.

Q. What about penalties on conversions from traditional IRAs to Roth IRAs?

A. The ten percent early withdrawal penalty is waived on IRA conversions.

Q. Are there different tax rules regarding withdrawals of IRA conversion contributions?

A. A distribution that is attributed to an IRA conversion contribution is not subject to income tax. If the distribution is made within five years after the conversion, then the ten percent early withdrawal tax applies unless there is an exception.

Q. Can I roll over funds from one Roth IRA to another Roth IRA?

A. Yes. A rollover or transfer from one Roth IRA to another Roth IRA is tax-free and can be made regardless of your MAGI.

Q. What should I do if I am eligible for both a Roth IRA and my company retirement plan, but I don't have enough money to contribute the maximum to both?

A. Experts recommend that you first contribute at least enough to your company plan to take full advantage of any employer match. After getting the full employer match, the best approach varies depending on your circumstances. Consult with a tax professional if you are unsure.

Q. Does it make sense to make an after-tax voluntary contribution to my company retirement plan instead of a Roth contribution?

A. With the same earnings rate, you can have more after tax dollars during retirement by making the Roth contribution. This will occur if you receive distributions after you attain age 59½ and at least five years after the year for which you made your first Roth contribution.

Q. Does it make sense to make a nondeductible contribution to a traditional IRA instead of a Roth contribution?

A. If you meet the age 59½ and five-year tests, with the same earnings rate, you will have more after-tax dollars during retirement by making the Roth contribution.

Q. What if I can deduct a contribution to a traditional IRA?

A. In general, a person who can afford to make the maximum Roth IRA contribution will benefit more from making Roth IRA contributions. This may not be true if you are close to retirement and it appears that your tax bracket will go down substantially after retirement. You should also consider a deductible traditional IRA contribution if losing the deduction would reduce the amount you can contribute. Seek tax advice if you are in doubt.

Q. Can my Roth IRA be inherited?

A. Yes. Upon your death, the entire proceeds can be passed on tax-free to your beneficiaries, once the five-year test has been met. This means there may be a delay before your beneficiaries will be able to receive the income earned within the Roth IRA on a tax-free basis.

Q. How will I know if I am a good candidate to convert my traditional IRA to a Roth IRA?

A. The desirability will differ with each individual's financial circumstances. Certainly, you should weigh the potential tax savings during retirement against the cost of your tax bill for the conversion. Because this decision is a complicated one, you should consult a tax professional. Consider several key questions:

- Would most of the funds in your traditional IRA be subject to income tax in the conversion?
- Can you afford to pay the income taxes due on the conversion from funds outside of your IRA funds?
- What tax bracket are you in now, and what tax bracket do you think you will be in when you retire?
- How long is it before you retire?
- Will the taxable income from the conversion bump you into a higher tax bracket?
- How will the income from the conversion affect the taxation of any Social Security retirement benefits you receive?
- Is the Roth IRA useful to you as an estate planning tool?

Q. I know about the federal taxes due on Roth accounts, but what about state taxes?

A. In many states, treatment of the Roth IRA for state tax purposes is the same as the treatment of the account for federal tax purposes by the IRS. Consult your tax adviser for more information on state taxes for the Roth IRA.

Not intended as tax advice. Please consult a tax professional.

More questions?

Ask your credit union.

We hope this brochure has answered your questions and helped you understand the Roth IRA. Due to the complexity of Roth IRAs, you should consult a tax professional before you make any decisions.

For more information, please call or stop by to see us.