



Understanding the Roth IRA

By: John Kaighn

The ROTH IRA is a retirement product which allows the withdrawal of tax free income from a tax deferred account, and it is a fantastic savings vehicle for people of any age, but particularly for younger people. Congress created The Roth IRA on January 1, 1998 as a result of the Taxpayer Relief Act of 1997. It's named after the late Senator William V. Roth, Jr. The Roth IRA is different from the Traditional IRA because it provides no deduction for contributions, but if you meet certain requirements, all earnings are tax free when you or your beneficiary withdraw them, whereas with the Traditional IRA taxes would be due upon withdrawal. Some other benefits of the ROTH IRA are no early distribution penalty on certain withdrawals, and there is no requirement to take minimum distributions after age 70½.

While the decision to use a ROTH IRA is based on several factors, the presence of a retirement plan in the workplace is one of the major reasons for utilizing a ROTH IRA. If you still have the ability to save, after committing the maximum contribution to your 401k plan, then the ROTH IRA makes sense, because you are limited in the tax deductibility of contributions to a Traditional IRA, if you have a workplace pension plan or 401k. For people who have no workplace retirement plan, the bottom line is that most people are better off with the Roth IRA. The reason is that the dollar amount in Roth IRA is effectively larger than a Traditional IRA because it holds after-tax dollars. If you can take advantage of this feature of the Roth IRA by maximizing your contributions you'll add greater tax leverage to your retirement savings.

There are two ways to establish a Roth IRA either by making a regular contribution to a Roth IRA or by converting a traditional IRA to a Roth IRA. As mentioned before, contributions can be made to a Roth IRA even if you participate in a workplace retirement plan. These contributions can be as much as \$4,000 for 2007 with a \$1,000 catchup for those 50 and older. There are just two requirements for contributing to the ROTH IRA. First, you or your spouse must have compensation or alimony income equal to the amount contributed. Secondly, your modified adjusted gross income can't exceed certain limits. For the maximum contribution, the limits are \$99,000 for single individuals and \$156,000 for married couples filing joint returns. The amount you can contribute is reduced gradually and then completely eliminated when your modified adjusted gross income exceeds \$114,000 for single individuals or \$166,000 for married couples filing jointly. These dollar amounts apply through 2007. You can convert your regular IRA to a Roth IRA if your modified adjusted gross income is \$100,000 or less, and if you're single or file jointly with your spouse. You'll have to pay tax in the year of the conversion, but for many people the long-term savings is preferable to consequences of the tax incurred.

Distributions from Roth IRAs are tax-free until you've withdrawn all your regular contributions. After that you'll withdraw your conversion contributions, if any. Special rules apply when you withdraw your conversion contributions. When you've withdrawn all your regular and conversion contributions, any subsequent withdrawals come from earnings. The withdrawals are tax-free if you're over age 59½ and at least five years have expired since you established your Roth IRA. Otherwise, with a few exceptions, they're taxable and potentially

subject to the early withdrawal penalty.

About the author: John Kaighn is a Registered Investment Advisor with Jersey Benefits Advisors and writes articles on various business and investment information, ideas and opportunities. For more information about this and other topics you can visit <http://www.johnkaighn.com> and <http://www.jerseybenefits.com>

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