

## **"The ABCs of Contributing to IRAs"**

by Mary Fricker, Staff Writer © 2006- *The Press Democrat*, June 12, 2006

**HARRY RUBINS**, financial consultant with Foothill Securities and owner of Rubins Financial Strategies in Santa Rosa for 20 years, discusses opportunities to save with Individual Retirement Accounts.

**PRESS DEMOCRAT:** What is an IRA?

**RUBINS:** An Individual Retirement Account (IRA) is a personal savings plan that offers tax advantages to help save for retirement. The traditional IRA started in 1975 with a maximum contribution of \$1,500. For 2006, the maximum contribution is \$4,000, or \$5,000 for anyone age 50, by Dec. 31. Contributions to a traditional IRA may be income-tax deductible and the earnings grow tax-deferred while accumulating in the plan. Because the intent of this plan is for retirement, there is an early withdrawal penalty of 12.5 percent if withdrawals are made before age 59½. Regardless at what age withdrawals are made, they are taxable as ordinary income. You must start taking a minimum distribution, about 4 percent, in the year you are age 70½ or you will be subject to a 50 percent penalty tax.

**PRESS DEMOCRAT:** Are there different types of IRAs?

**RUBINS:** Besides the traditional IRA for annual contributions, there are many different types of IRAs. Spousal IRAs allow nonworking spouses to have contributions made to their own IRA account by the working spouse. IRA rollover accounts allow transfers from employer 401(k) and Profit Sharing plans. Roth IRAs are sometimes called the "back end" IRA because withdrawals are tax-free, but the contributions are not tax deductible. Custodial IRAs provide management for children younger than 18 to have a traditional IRA or inherit an IRA. There are business sponsored IRAs that allow small business owners and employees, if any, to save for retirement. The employee salary deferral Simple IRA has become very popular for groups under 100 employees and the SEP IRA for profit-sharing contributions.

**PRESS DEMOCRAT:** Who is eligible to set up an IRA?

**RUBINS:** Any individual can open and make contributions to a traditional IRA, if they received taxable wages from employment during the year, as long as they are not 70½ by the end of the year. If an individual only has Social Security, investment earnings or interest, they are not eligible to make an IRA contribution. If a teenager is employed this summer and is under age 18, the parent can open a Custodial IRA for the child's benefit and get them started at an early age saving for retirement. This is a great opportunity to start them on smart saving habits and introduce financial education.

**PRESS DEMOCRAT:** How do you set up an IRA?

**RUBINS:** You must complete an IRA application at a bank, credit union, mutual fund, brokerage account, annuity or special IRA trust custodian. The deadline for making 2006 contributions is April 15, 2007. There may be a nominal set-up charge and annual custodial fee, typically less than \$35. Contributions can be made annually or set up as a monthly systematic deposit from your bank account for as little as \$50 a month. This is a great way to put your savings on automatic pilot just like a salary deferral 401K plan at work.

**PRESS DEMOCRAT:** Are some investments more suitable for IRAs than others?

**RUBINS:** An IRA is a savings plan and, depending on what the custodian will allow, most of your typical investments are available, such as stocks, bonds, mutual funds, CDs, limited partnerships and real estate. Direct ownership of rental real estate is possible, but it is very complex and not generally recommended. Life insurance, personal residence and collectibles such as antiques, stamps and, sorry to say, wine, are not allowed. Also, any investments that might benefit you or any relative personally or in business are not allowed.

**PRESS DEMOCRAT:** What are the biggest mistakes people make with IRAs?

**RUBINS:** It depends on whether it's your IRA or an IRA that you inherit. For your own IRA, the biggest mistake is to not start when you are young. However, it's never too late to begin. It's an amazing fact that 20-year-old starting annual contributions will have well over \$1 million at age 60. Time and tax-deferred earnings create substantial wealth. The other mistake is naming your living trust as a beneficiary of your IRA. It is a real problem when your heirs take over. For an inherited IRA, the biggest mistake is making decisions on your own without professional help. The regulations governing inherited IRAs are more complex, and costly mistakes are easy to make, with 50 percent penalties and huge income tax payments. Done correctly, the heir can defer income taxes over their lifetime, creating substantial wealth. To help clients and professional advisers, I have created an informative action list "Road Map for Beneficiaries Inheriting IRAs, 401Ks and Roth IRAs."

**PRESS DEMOCRAT:** How can a consumer decide whether to have a regular IRA or a Roth IRA, and what are the differences?

**RUBINS:** If you are eligible for a tax-deductible traditional IRA that would be the first choice. Roth IRAs are the preferred choice if you are excluded from a tax deductible traditional IRA because you are participating in a company plan and your income exceeds the IRS limits. A Roth may still be a good choice for somebody who is young (18 to 20 years old) and is in a low tax bracket. The Roth has other advantages that make them attractive. The withdrawals of contributions can be made from the account prior to age 59½ without any penalty or income taxes, and there are no 70½ Required Minimum Distributions, so you have control over distributions.

**PRESS DEMOCRAT:** What are the new laws and changes that apply to IRAs?

**RUBINS:** For 2006, the IRA/Roth contribution amount was increased by \$500 for age 50 or older, to \$5,000. The \$4,000 limit for younger than 50 is unchanged. The recent tax act signed by President Bush in May eliminated the income cap on Roth IRA conversions but you'll have to wait until 2010. Currently, anyone earning more than \$100,000, single or married, cannot convert an IRA to a Roth IRA. Since Jan. 1, there are more opportunities to make Roth contributions. 401K salary deferral plans at work now may add an option to let you make contributions for a Roth, in addition to your tax deductible 401K. Contact your employer for more information. The FDIC insurance protection for CDs in IRAs was increased from \$100,000 to \$250,000 per account. 2006 is the last year that a low- or moderate-income taxpayer can receive a tax credit for contributions to their IRA, Roth or 401K. In 2005, Congress passed a law protecting IRA accounts from creditors.

**PRESS DEMOCRAT:** You have said that IRAs can be a good way to make donations to charities. How does that work?

**RUBINS:** Donating your IRA to a charity during your lifetime is a problem because you pay taxes on the withdrawal and you may not have an offsetting charitable tax deduction. So the transfer of your IRA upon death where the charity is listed as your beneficiary is generally recommended. It makes no difference to the charity if the bequest comes from your will or trust or your taxable IRA, as charities are tax exempt. But for your children, it does make a difference. Your children not only inherit the IRA but also the income taxes you never paid. Designate your IRA for charitable giving and everyone comes out ahead. Check with your attorney and financial advisor.

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