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THE DIFFERENT TYPES OF IRAS AVAILABLE TODAY

The following is designed to help you differentiate between the different types of Individual Retirement Accounts (IRAs) available today, identify those for which you qualify and which may be best for you. It covers the main points of each type of IRA and suggests you talk to your professional adviser for more details.

At one time, there was relatively little confusion about IRAs because there was only one type available. Now, however, IRAs have proliferated—there's the regular IRA, which may be funded with deductible and/or nondeductible contributions, Roth IRA, SEP-IRA, SIMPLE IRA and, finally, what until recently was called the education IRA.

Some of these IRAs are similar, but others have little in common. To compound the confusion, some IRAs are known by different names. For example, a non-Roth retirement-savings IRA sometimes is called a traditional IRA, and what used to be called education IRAs now are called Coverdell Education Savings Accounts. What do all these IRAs have in common? They can help you and your family save significant amounts for retirement, or a child's education, on a tax-favored basis.

Here's an overview of the different types of IRAs available today.

TRADITIONAL IRAS

Traditional IRAs can be funded with deductible and nondeductible contributions.

— *Deductible IRA Contributions.*

You can make an annual deductible contribution to an IRA if:

1. You (and your spouse) are not an active participant in an employer-sponsored retirement plan; or

2. If you (or your spouse) are an active participant in an employer plan and your modified adjusted gross income (AGI) doesn't exceed certain levels which vary from year-to-year by filing status.

For example, if you are a joint return filer covered by an employer plan, your deductible IRA contribution phases out over $53,000 to $63,000 of modified AGI ($54,000 to $64,000 for 2002). If you're single or a head of household, the phaseout range is $33,000 to $43,000 ($34,000 to $44,000 for 2002). For a married filing separately, the phaseout range is $0 to $10,000 (for all years). If you are not an active participant in an employer-sponsored retirement plan but your spouse is, your deductible IRA contribution phases out over $150,0000 to $160,000 of modified AGI.

Deductible IRA contributions reduce your current tax bill, and earnings within the IRA are tax-deferred. However, every dollar you take out is taxed in full (and subject to a 10% penalty if you withdraw money before age 59-1/2, unless one of several exceptions apply). You must begin making minimum withdrawals by April 1st of the year following the year you attain age 70-1/2.

, *Nondeductible IRA Contributions.*

You can make an annual nondeductible IRA contribution without regard to your coverage by an employer plan and without regard to your AGI. The earnings in a nondeductible IRA are tax-deferred within the IRA but are taxed (and subject to a 10% penalty if you withdraw money before age 59-1/2, unless one of several exceptions apply).

You must begin making minimum withdrawals by April 1st of the year following the year you attain age 70½. Nondeductible contributions aren't taxed when they are withdrawn. If you've made deductible and nondeductible IRA contributions, a portion of each IRA distribution is treated as coming from nontaxable IRA contributions (and the rest is taxed).

If you can't make a deductible contribution to a traditional IRA, you should contribute (if eligible) to a Roth IRA instead of making a nondeductible contribution to a traditional IRA. That's because the Roth IRA offers a better package of tax benefits than you'd get by making a nondeductible contribution to a traditional IRA.

, *Deductible and Nondeductible IRA Limits.*

The maximum annual IRA contribution (deductible or nondeductible, or a combination) for 2001 is $2,000, but it will be $3,000 for 2002 ($3,500 if you are age 50 or over in 2002). Additionally, your IRA contribution for a year (deductible or not) can't exceed the amount of your compensation includible in income for that year. Deductible and nondeductible IRA contributions can't be made once you attain age 70-1/2.

IRAs often are referred to as “traditional IRAs” (or “regular IRAs”) to distinguish them from Roth IRAs.

\# **ROTH IRAS**

You can make an annual contribution to a Roth IRA if your AGI doesn't exceed certain levels that vary by filing status. For example, if you are a joint return filer, the maximum annual Roth IRA contribution phases out over $150,000 to $160,000 of modified AGI ($95,000 to $110,000 for single taxpayers). Annual contributions to Roth IRAs can be made up to the amount that would be allowed as a contribution to a traditional IRA, reduced by the amount you contribute for the year to non-Roth IRAs, but not reduced by contributions to a SEP-IRA or SIMPLE IRA (see below). For example, if you don't contribute to a traditional IRA in 2002, you can contribute up to $3,000 to a Roth IRA for that year ($3,500 if you are age 50 or older in 2002).

Roth IRA contributions aren't deductible. However, earnings are tax-deferred within the Roth IRA and (unlike a traditional IRA) are tax-free if paid out (1) after a five-year period that begins with the first year for which you made a contribution to a Roth

IRA, and (2) once you reach age 59-1/2, or upon death or disability, or (up to $10,000 lifetime) for first-time homebuyer expenses of you, your spouse, child, grandchild or ancestor. And, if a Roth IRA payout doesn't meet these dual conditions, you're treated as first withdrawing nontaxable Roth IRA contributions; the balance (representing earnings) is taxed and is subject to a 10% penalty for pre-age-59-1/2 withdrawals, unless one of several exceptions apply. Thus, for example, if you contribute $6,000 over the years to Roth IRAs and withdraw $9,000 at age 55 to buy a boat, only $3,000 is taxed (and is subject to the 10% penalty).

You can make Roth IRA contributions even after you attain age 70-1/2 (if you have sufficient compensation income), and you do not have to take minimum distributions from a Roth IRA after you attain that age. That makes Roth IRAs an excellent wealth-building vehicle for your family.

You can “roll over” (or convert) a traditional IRA to a Roth IRA in a year that your AGI as specially computed doesn't exceed $100,000, but the amount taken out of the traditional IRA is treated for tax purposes as a regular withdrawal (but it's not subject to the 10% early withdrawal penalty).

SEP-IRAS AND SIMPLE IRAS

Small businesses that want to provide employees with a retirement plan but keep administrative costs low may be able to set up a SEP (Simplified Employee Pension) or SIMPLE (Savings Incentive Match Plan for Employees) plan. In either type of plan, contributions are made to IRA-type accounts in the employees' names. Annual contributions to these plans are controlled by special rules and aren't tied to the normal IRA contribution limits. Distributions from a SEP-IRA or SIMPLE IRA are subject to tax rules similar to those that apply to deductible IRAs.

EDUCATION IRAS

The education IRA (recently renamed as the Coverdell Education Savings Account) is a special savings account that provides for a child's education. Although there is no deduction for contributions made to an education IRA, the earnings on contributions build up on a tax-deferred basis within the account and are free of tax if paid out for qualified expenses, such as a child's higher education. The earnings portion of a distribution not used for qualified purposes is taxed and generally is subject to a 10% penalty tax as well.

The total amount of contributions that can be made to any one child's education IRAs is $500 per year for 2001, but beginning in 2002, the limit will be $2,000 per year per child. For joint return filers, the maximum annual education IRA contribution phases out over $150,000 to $160,000 of AGI as specially computed ($190,000 to $220,000 for 2002); it's $95,000 to $110,000 for other filers (with no increase after 2001). There are many changes in the works for education IRAs. For example, beginning in 2002, qualified expenses for which tax-free distributions can be made will include kindergarten, primary and secondary school (private as well as public) tuition and associated costs as well as higher education expenses.

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designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 972/934-1577 or e-mail at info@facpa.com.