IRAs Can Help During Tax Time, *The Concord Journal*, March 29, 2012
By David Chwalek

As April 15th approaches- well, April 17th this year- taxpayers throughout the Commonwealth may be scrambling getting their tax returns ready and looking for last-minute strategies to reduce taxes. Unfortunately, at this point, there is not much that can be done to save money on last year's taxes, although there is one simple option still available to many Americans.

The Individual Retirement Account or IRA, as it's commonly referred to, was first introduced in 1974. Initially, only workers not covered by an employer-sponsored retirement plan were eligible to contribute. The initial maximum contribution was $1,500 per year. Over the years, many enhancements have been made to the IRA including higher contribution limits, the ability to put in money for a non-working spouse, more widespread eligibility and a "catch-up" provision.

Today, Americans can contribute up to $5,000 annually and another $1,000 if they're over 50 years old. IRAs are easy to set up and can be established at most banks and investment firms. You can choose to invest your IRA assets in nearly anything- stocks, bonds, mutual funds, certificates of deposit, annuities, and, in some cases, even real estate. Keep in mind that, except for some bank products, IRAs are not guaranteed and are subject to market risk just like any other investment. Money invested in an IRA is tax-deductible, thus offering an incentive to lower your current taxes as well as save for retirement. All earnings grow tax-deferred in an IRA but all funds are fully taxed as ordinary income when withdrawn. The premise is that most people are in a lower tax bracket when they stop working and retire than when they are fully employed.

Despite the benefits, there are potential disadvantages as well. Because you receive a tax break up front and IRA money is designed for retirement, early withdrawals- those taken prior to age 59 ½ - are subject to early withdrawal penalties. The IRS will assess a 10% penalty on funds taken out and the proceeds become fully taxable in the year the withdrawal is made. In addition, the IRS requires you to begin liquidating your IRA once you turn 70 ½.

The Taxpayer Relief Act of 1997 introduced a new retirement account option for Americans. The Roth IRA features the same maximum contribution levels as the Traditional IRA, but the tax ramifications are essentially the opposite. There is no upfront deduction for contributions, but qualified withdrawals (at age 59 ½ or later) are income tax free. Like the Traditional IRA, all earnings grow tax-deferred as well. The idea here is that you pay your taxes upfront then enjoy tax-free retirement income.

In general, the Roth offers greater flexibility than its' traditional counterpart. All contributions made to a Roth can be withdrawn at any age without tax or IRS penalty (remember, you already paid tax on the contributions). Earnings withdrawn prior to age 59 ½ are still taxable and subject to penalty. Another nice feature is that you never *have* to withdraw money from a Roth- there is no Required Minimum Distribution at age 70 ½ as with a Traditional IRA. For many people, the main drawback to the Roth IRA is the income limits. In 2012, you can only contribute the maximum to a Roth if your income is below $110,000 ($173,000 if married filing jointly).

So which IRA is best? That's a tough question and the answer depends on your individual situation. However, if you are looking to save money on your taxes *now*, then you might go with the Traditional IRA. Likewise, if you expect your income to be significantly lower during your retirement years than it is now, the Traditional route might be best. On the other hand, if you are in a lower tax bracket now but expect your income to increase in the future and in retirement, it might make sense to bite the tax bullet now and save later. If you expect, like many Americans, that tax rates will be higher in the future, again, the Roth may be your best bet. And if you would like some flexibility with your retirement savings, then the Roth is generally more flexible than the Traditional IRA.

One additional option for self-employed people is the SEP-IRA. The SEP offers the same tax treatment as a Traditional IRA, but allows for much higher contributions based on your income. If you are an incorporated business, in 2012 you may contribute 25% of your W-2 income up to a maximum of $50,000. If you're not incorporated, then you can put in 20%, also up to $50,000.

One last benefit, which applies to all of the above-mentioned plans, is that you actually have until the tax-filing deadline to set up IRAs or make contributions for the previous tax year. Here in Massachusetts, you can still make contributions for 2011 up until April 17th, 2012. So, it's not too late to add to your accounts for 2011, but time is quickly running out.

David Chwalek is a partner with Senes & Chwalek Financial Advisors and a Registered Representative of Investors Capital Corporation, Member FINRA, SIPC, 57 Main Street, Concord, MA 01742. His website is www.senesandchwalek.com and he can be reached at (978) 369-2255. *Views and opinions expressed are those of David Chwalek and are subject to change based on market and other conditions. The information provided is general in nature and should not be construed as tax or investment advice. Consult your investment professional regarding your unique situation.*