Independent Investor
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Keeping Up With Your IRA: Tax Season Tips

If you're one of the millions of Americans who owns either a traditional individual retirement account (IRA) or a Roth IRA, then the approach of tax season should serve as a reminder to review your retirement savings strategies and make any changes that will enhance your prospects for long-term financial security. It's also a good time to open an IRA if you don't already have one.

The deadline for funding an IRA for tax-year 2013 is April 15. The following checklist should provide you with food for thought as you plan your IRA moves in the coming weeks.

Which Account: Roth IRA or Traditional IRA?

The primary difference between a traditional IRA and a Roth IRA is the tax treatment of contributions and distributions (withdrawals). Traditional IRAs may allow a tax deduction based on the amount of a contribution, depending on your income level. Any account earnings compound on a tax-deferred basis, and distributions are taxable at the time of withdrawal at then-current income tax rates. Roth IRAs do not allow a deduction for contributions, but account earnings and qualified withdrawals are tax free.[1]

In choosing between a traditional and a Roth IRA, you should weigh the immediate tax benefits of a tax deduction this year against the benefits of tax-deferred or tax-free distributions in retirement. If you need the immediate deduction--and you qualify for it--then you may wish to opt for a traditional IRA. If you don't qualify for the deduction, then it is almost certainly a better idea to fund a Roth IRA.

Deductibility Guidelines

Your ability to deduct contributions to a traditional IRA is affected by whether you are covered by a workplace retirement plan and your income level. If you are covered by a retirement plan at work, your deduction for contributions made to a traditional IRA in 2013 will be reduced (phased out) if your modified adjusted gross income (MAGI) in 2013 was:

- Between $95,000 and $115,000 for a married couple filing a joint return.
- Between $59,000 and $69,000 for a single individual or head of household.
- If your MAGI was higher than the phase-out ceilings listed above for your filing status, then you cannot claim the deduction.

Note that the deductibility phase-out ranges for the 2014 tax year are:

- Between $96,000 and $116,000 for a married couple filing a joint return.
- Between $60,000 and $70,000 for a single individual or head of household.

Should You Convert to a Roth?

The IRS allows you to "convert"--or change the designation of--a traditional IRA to a Roth IRA regardless of your income level. As part of the conversion, you must pay taxes on any investment growth in--and on the amount of any deductible contributions previously made to--the traditional IRA. The withdrawal from your traditional IRA will not affect your eligibility for a Roth IRA or trigger the 10% penalty normally imposed on early withdrawals.

The decision to convert or not ultimately depends on your timing and tax status. If you are near retirement and find yourself in the top income tax bracket this year, now may not be the time to convert. On the other hand, if your income is unusually low and you still have many years to retirement, you may want to convert.

Maximize Contributions

If possible, try to contribute the maximum amount allowed by the IRS: $5,500 per individual, plus an additional $1,000 in catch-up contributions for those aged 50 and older. These amounts pertain to tax-year 2013 as well as tax-year 2014.

Of course, not everyone can afford to contribute the maximum to an IRA, especially if they are also contributing to an employer-sponsored retirement plan. If your workplace retirement plan offers an employer's matching contribution, then that "free" money may be more valuable than the amount of any deduction you may be able to claim. As a result, it might make sense to maximize plan contributions first, and then try to maximize IRA contributions.

Review Distribution Strategies

If you are ready to start making withdrawals from an IRA, you will need to choose which distribution strategy to use: a lump-sum distribution, required minimum distribution or periodic distribution.

Keep in mind that your distribution strategy may have significant tax time implications if you own a traditional IRA, because taxes will be due at the time of withdrawal. Be sure to consult with your financial and/or tax advisor about the tax ramifications of the various distribution methods before selecting a distribution strategy.

April 15 is never that far away--so don't hesitate to use the remaining time between now and then to shore up the IRA strategies you will rely on to help support you in retirement.

[1]*Early withdrawals (before age 59½) from a traditional IRA may be subject to an additional 10% penalty tax. Early and other nonqualified withdrawals from a Roth IRA may be subject to taxation as well as the 10% penalty.*