Roth IRAs

Make an informed decision
to fit your situation.

Allianz

Allianz Life Insurance Company of North America
Allianz Life Insurance Company of New York

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SAVING FOR RETIREMENT CAN FEEL DAUNTING AT TIMES.

Whether you use a 401(k) plan through your employer, an individual retirement arrangement (IRA), or are planning to supplement your retirement needs with another source, it's possible you've wondered if a Roth IRA could help meet your retirement needs.

Before you weigh the options, it's important to understand what a Roth IRA is and the special rules involved. Talk with your tax advisor and your financial professional to help you determine if it's an appropriate option to consider.

WHAT ARE THE TYPES OF INDIVIDUAL RETIREMENT ARRANGEMENTS (IRAS)?

The Internal Revenue Service (IRS) allows individuals who have earned income as an employee or contractor to make annual contributions to a traditional IRA or to a Roth IRA, subject to certain requirements.

WHAT MAKES TRADITIONAL IRAS DIFFERENT FROM ROTH IRAS?

Traditional IRAs are generally funded with before-tax dollars and are generally fully taxable when withdrawn. The owner of a traditional IRA has required minimum distributions (RMDs) when they attain age 72 and older (age 70½ for IRA owners born before June 30, 1949). If withdrawals are taken before age 59½, they may be subject to a 10% federal additional tax.

Roth IRAs, on the other hand, are funded only with after-tax dollars. Distributions after age 59½ are completely income-tax-free as long as the Roth IRA owner has met a five-year requirement, determined by the date the owner first funded any Roth IRA. No required minimum distributions apply during the owner's lifetime, but certain RMD rules do apply to Roth IRA beneficiaries.

AM I ELIGIBLE FOR A ROTH IRA?

Two things determine whether you can open a new Roth IRA or continue to contribute to an existing Roth IRA:

1. Your current annual income
2. Your tax filing status

First, you must have "earned income" – usually in the form of salary, wages, or profits from a small business.

If you have earned income, you must confirm you are within the federal government limits for total annual contribution to your Roth IRA. Note that any contribution to a traditional IRA reduces the annual amount you may contribute to a Roth IRA. Note that the amounts differ depending on your tax status.

There are also earning limits on who can contribute to a Roth IRA, based on your modified adjusted gross income (MAGI). Your MAGI is calculated by deducting things like student loan interest and higher education expenses from your adjusted gross income.

2020 Roth IRA contribution limits

Qualifications: earned income

Roth IRA contribution (under age 50)	$6,000
Roth IRA contribution (age 50 and older)	$7,000

Roth IRA contribution eligibility phase-out	Modified adjusted gross income (MAGI)
Single or head of household (HOH)	$124,000 - $139,000
Married, filing jointly	$196,000 - $206,000
Married, filing separately	$0 - $10,000

Deadline is usually April 15 of the following year.

WHAT IS A ROTH IRA CONVERSION?[1]

A Roth IRA conversion is possible if you own a traditional IRA and want to convert to a Roth IRA instead. Roth IRA conversions can also happen if you have pre-tax funds in a 401(k) plan and roll over the funds to a Roth IRA. When you convert from a traditional IRA to a Roth IRA, or from a qualified plan like a 401(k) plan to a Roth IRA, you owe income taxes on the amount converted in the year of the conversion. Upon the conversion, many people prefer to pay these taxes with funds outside their IRA or qualified retirement plan. If you elect to take a distribution from your IRA or qualified retirement plan to pay the conversion taxes, please keep in mind the potential consequences – such as an assessment of product surrender charges or an additional IRS tax for premature distributions.

WHAT ARE SOME OF THE ADVANTAGES OF A ROTH IRA?

- Qualified distributions from Roth IRAs are income-tax-free.
- Unlike the case for a qualified retirement plan such as a 401(k), there is no mandatory 20% withholding for Roth IRA distributions, though taxable Roth IRA distributions may be subject to a 10% withholding unless there is an election made for no withholding.
- There are no RMDs for Roth IRA owners, but certain RMD rules do apply to Roth IRA beneficiaries.

WHAT ARE SOME OF THE DISADVANTAGES OF A ROTH IRA?

- Contributions to a Roth IRA are never tax-deductible.
- Contributions to a Roth IRA are not available for certain high-income individuals.

[1] Please remember that converting an employer plan account or traditional IRA to a Roth IRA is a taxable event. Increased taxable income from the Roth IRA conversion may have several consequences including (but not limited to) a need for additional tax withholding or estimated tax payments, the loss of certain tax deductions and credits, and higher taxes on Social Security benefits and higher Medicare premiums. Be sure to consult with a qualified tax advisor before making any decisions regarding your IRA.

- Only individuals who have earned income may contribute to a Roth IRA. "Earned income" includes salaries, wages, bonuses, tips, commissions, or similar income that results from an individual's personal labor or services.
- If an individual's ordinary income tax bracket is expected to drop in retirement, for some individuals it might be better to maximize tax deductions to traditional IRAs or 401(k) accounts today if they qualify.
- For nonqualified distributions from a Roth IRA, any earnings distributed will be taxed as ordinary income and may be subject to a 10% federal additional tax.
- Funds in Roth IRAs may not be rolled over to a qualified plan.

WHAT ARE SOME OF THE ADVANTAGES OF A ROTH IRA CONVERSION?

- Roth IRA conversions are not subject to a 10% federal additional tax, though the amount converted is subject to ordinary income tax.
- Conversion may be preferable if the income tax bracket is projected to be the same or higher at time of distribution than at time of conversion. A Roth IRA conversion could lower your income tax bracket in the future since qualified distributions from a Roth IRA are income-tax-free.
- See the section "What are the advantages of a Roth IRA?"

WHAT ARE SOME OF THE DISADVANTAGES OF A ROTH IRA CONVERSION?[1]

- Roth IRA conversions are subject to ordinary income tax on the entire amount converted.
- When converting a traditional IRA annuity, the taxable amount of conversion may be larger than expected.
- Distributions from the traditional IRA or qualified plan may be needed to pay the taxes due at conversion.
- Surrender or withdrawal charges may apply when converting a traditional IRA to a Roth IRA.

[1] Please remember that converting an employer plan account or traditional IRA to a Roth IRA is a taxable event. Increased taxable income from the Roth IRA conversion may have several consequences, including (but not limited to) a need for additional tax withholding or estimated tax payments, the loss of certain tax deductions and credits, and higher taxes on Social Security benefits and higher Medicare premiums. Be sure to consult with a qualified tax advisor before making any decisions regarding your IRA.

- Increased taxable income from the Roth IRA conversion may have several consequences including (but not limited to) a need for additional tax withholding or estimated tax payments, the loss of certain tax deductions and credits, and higher taxes on Social Security benefits and higher Medicare premiums.
- Post December 31, 2017, Roth IRA conversions are no longer eligible for a recharacterization (an "unwinding" of a conversion).
- Traditional IRA assets, fees, and costs may be more favorable than Roth IRA assets, fees, and costs.
- See the section "What are the disadvantages of a Roth IRA?"

HOW ARE DISTRIBUTIONS FROM A ROTH IRA TAXED?

If the withdrawal is a qualified distribution (see below), there is no income tax. If the withdrawal is not a qualified distribution, any earnings distributed will be taxed as ordinary income and may be subject to a 10% additional tax. Any conversions distributed – including those done as rollovers to Roth IRAs from employer retirement plans – may be subject to an additional 10% federal tax for early distributions. Ordering rules can work in your favor to help avoid these taxes.

WHAT IS A QUALIFIED DISTRIBUTION?

Qualified distributions from Roth IRAs are income-tax-free and exempt from the 10% federal additional tax for early distributions. A distribution from a Roth IRA is qualified if the owner funded any Roth IRA more than five years ago (whether or not it's the Roth IRA being drawn from) and has one of these qualifying events:

- Age 59½ or older
- Death
- Disability
- First-time home purchase (up to a $10,000 lifetime limit)

Note that the five-year period starts on the first day of the taxable year when the owner first funded any Roth IRA, either by contribution or conversion, and did not revoke that Roth IRA.

WHAT IS A QUALIFIED DISTRIBUTION? (CONTINUED)

Hypothetical example

Ethan funds his first Roth IRA the year he turns age 57.

Any distribution he takes after the year he turns age 61 (five taxable years and over age 59½) is income-tax-free and free from the 10% federal additional tax for early distributions.

WHAT IF THE DISTRIBUTION IS NOT A QUALIFIED DISTRIBUTION?

Withdrawn earnings are taxed as ordinary income, and subject to 10% federal additional tax unless an exception applies. However, you can take advantage of ordering rules to help avoid the income tax and 10% federal additional tax.

WHAT ARE THE ORDERING RULES?

Nonqualified distributions are withdrawn in this order:

First	Second	Third
Contributions (e.g., the $6,000- or $7,000-per-year amounts)	Conversions (including from employer retirement plans) on a first-in first-out (FIFO) basis	Earnings

Note that there are rules for determining which category applies when money is rolled over from a designated Roth account to a Roth IRA. Designated Roth accounts are Roth 401(k), Roth 403(b), or Roth governmental 457(b).

HOW ARE THE CONTRIBUTIONS OF A NONQUALIFIED DISTRIBUTION TAXED?

Contributions are considered to come out first at the time of withdrawal – so they are not subject to income tax or the 10% federal additional tax for early distributions.

HOW ARE CONVERSIONS (INCLUDING FROM EMPLOYER RETIREMENT PLANS) OF A NONQUALIFIED DISTRIBUTION TAXED?

Conversions are considered to come out second at the time of withdrawal and are never subject to income tax (since they were taxed when converted). They may, however, be subject to the 10% federal additional tax if removed within five years of the conversion. This five-year period starts on the first day of the taxable year when the conversion was made. The 10% federal additional tax is not assessed on the converted amount withdrawn if an exception, such as one of the following exceptions, applies.

- Age 59½
- Death
- Disability
- First-time home purchase (up to a $10,000 lifetime limit)
- Substantially equal periodic payments
- Deductible medical expenses
- Health insurance premiums for unemployed individuals
- Higher education expenses
- Military reservists called to active duty
- $5,000 following the birth or adoption of a child

Hypothetical example

Maddie made a $3,500 Roth IRA contribution and has never had another Roth IRA. At the time of the contribution, she also converted a $20,000 traditional IRA to a Roth IRA. Two years later, the combined Roth IRAs equal $23,500 and now include $1,000 of extra earnings for a total of $24,500.

Maddie, now age 42, withdraws $6,000 for a first-time home purchase. Because this is an exemption included on the list and it is less than the $10,000 lifetime limit, the distribution will not be subject to the 10% federal additional tax, even though she started her Roth IRA with both contributions and conversion funds less than five years ago. If an exception had not applied, $2,500 would have been subject to the 10% federal additional tax.

HOW ARE EARNINGS ON A NONQUALIFIED DISTRIBUTION TAXED?

The earnings portion of a nonqualified distribution is subject to income tax and the 10% federal additional tax. However, the 10% federal additional tax may be waived if any of the exceptions – including those listed above – apply.

TAKE THE TIME TO MAKE AN INFORMED DECISION

Some options may seem appropriate at first glance, but are limiting in the long run – like taking a lump sum for cash to purchase something you've always wanted that turns out to be costly in the long term; leaving funds in an existing IRA for convenience but compromising your control and flexibility; or rolling over IRA funds to a different traditional or Roth IRA with higher costs and fees. That's why taking time to understand your options and consider the facts before making a decision is important.

MAKE A DIFFERENCE IN YOUR FINANCIAL FUTURE

You have choices and the final decision is up to you. The sooner you start planning, the more time you'll have. And more time – when used wisely – could mean more money for your retirement years.

Contact your tax advisor and financial professional to learn more about a Roth IRA and the options available for your own situation.

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