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**Retirement Planning Can Start with an IRA**

*These accounts make a good “first step” in retirement saving.*

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Sooner or later, people decide to start saving and investing for retirement. When that starting point arrives, taking that “first step” can seem like a big deal. Opening an Individual Retirement Account (IRA) amounts to an easy “first step” in retirement saving for many.

When you invest through a traditional or Roth IRA, you give those invested assets the potential to grow with compounding and you also position yourself for present or future tax savings.

**How does an IRA work?** An IRA is not an investment in itself, but an account into which various investments can be placed. It is yours; you control it. In that way, it differs from an employer-sponsored retirement account that you lose immediate control over when you leave a job.1

IRAs are tax-advantaged. In both Roth and traditional IRAs, account earnings compound with tax deferral until withdrawn – that is, they grow without being taxed.

With a traditional IRA, contributions are usually tax-deductible, based on your income, but withdrawals are taxed as ordinary income after age 59½ (a 10% penalty often applies to withdrawals made before that). With a Roth IRA, tax-deductible contributions are not permitted, but your earnings can be withdrawn tax-free. (Contributions will not be taxed when you withdraw them either, as long as you are the original IRA owner and have had the Roth IRA for more than five years.)1

So there you have the main difference between a traditional IRA and Roth IRA: while both give you a chance to build retirement savings with tax advantages, the traditional IRA offers you a sizable tax break today while the Roth IRA offers you a big tax break tomorrow. Or to put it another way (as some have), a traditional IRA lets you amass tax-deferred savings while a Roth IRA lets you amass tax-exempt savings.1,2

**Should you open a traditional IRA or Roth IRA?** Several variables should be considered as you make your choice, and a chat with a financial professional can help you weigh them. One key question to consider: do you think you will be in a lower tax bracket when you retire? If you do, a traditional IRA might be the better choice. If you have decades to go until retirement and think you will retire to a higher tax bracket than you are in today, the Roth IRA may be the better choice. Some savers “hedge their bets” and open Roth *and* traditional IRAs.3

Given compounding, the future tax break offered by a Roth IRA may be profound indeed. Roth IRAs also have two other compelling features. One, you never have to make mandatory withdrawals from them starting in your seventies (as with traditional IRAs). Two, you can keep contributing to them all your life, whereas contributions to a traditional IRA are prohibited after the year in which you turn 70½. Certain couples and individuals cannot have Roth IRAs, however, as they have incomes well over $100,000 (the precise thresholds are periodically adjusted upward for inflation).1

Some traditional IRA owners convert their accounts to Roth IRAs. That is a taxable event, and if the traditional IRA is large, a Roth conversion may not be worth the effort: the resulting income tax bill may be too large to handle and even offset the potential long-range benefits.3

**How do you open an IRA?** Just about any financial professional can help you do that; you can even do it online and at many bank and credit union branches. You should try to open one with low annual fees, as even a 1% annual account fee subtly eats into your IRA balance. Quite often, opening an IRA is just a matter of filling out an application (and a beneficiary form) and writing a check. Alternately, you may be able to transfer money from a bank account to start an IRA.4

**What are the drawbacks of IRAs?** First, their annual contribution limits. Right now, you can only contribute a maximum of $5,500 a year to a traditional or Roth IRA ($6,500 if you are 50 or older). If you have multiple IRAs, your total yearly contributions to all of them must not exceed that limit or you will incur an IRS penalty. This annual contribution ceiling is low compared to common workplace retirement plans such as 401(k)s and 403(b)s.5

Many Americans would like a retirement account that never loses money. A Roth or traditional IRA is not that account. IRA assets are not usually allocated to riskless investments, and when you have investment risk, you have potential for investment losses. IRAs are not insured by the FDIC or any other federal agency.1

In response to the desire for riskless retirement saving, the federal government recently created the myRA, a Roth IRA whose value is guaranteed to increase. Its return is pegged to the return of the government securities fund for federal employees, which averaged 3.39% a year from 2003-2013. The myRA yearly contribution limits are exactly the same as yearly Roth IRA contribution limits. After 30 years or when its balance hits $15,000, a myRA converts to a private-sector Roth IRA. A myRA is basically a vehicle to help Americans who have few or no avenues to save for retirement due to their line of work or income levels.6,7

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**Citations.**

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2 - fool.com/money/allaboutiras/allaboutiras03.htm [2/16/15]

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