

Invest in Your Future: What is an IRA?



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OTHER THAN A PILE OF MONEY your uncle brags about at holiday gatherings, an IRA (short for Individual Retirement Account) is an account that allows you to put money aside in a way that saves you dollars at tax time. Contributions to and withdrawals from different types of IRAs receive different types of tax treatment, but while your money is in an IRA, it is not taxed.

That's different from a normal non-retirement type account, which is taxed on dividends, income, and capital gains as they are credited to your account, whether or not you make withdrawals. The tax-advantaged treatment of IRAs can be an extremely powerful financial tool, and has made IRAs a popular way to save for and fund your goals, in particular, your retirement.

The two most popular types of IRAs are Traditional IRAs and Roth IRAs. Your contributions to a Roth IRA are not tax-deductible, but once you meet the holding requirements, you can withdraw both your contributions and earnings completely tax-free. While your contributions to a Traditional IRA are typically tax-deductible and will reduce your current tax bill, withdrawals are fully taxable.

IRAs and the IRS

When you contribute to an IRA, you essentially agree to set the contributed funds aside for your retirement. If you make a withdrawal prior to reaching retirement, which the IRS defines as age 59.5 (whether you're actually retired or not), you will be penalized 10 percent of the amount you withdraw. There are some exceptions, but they are complicated by multiple restrictions.

When contributing to an IRA, you must be sure to follow the guidelines set by the IRS. First and foremost, to be eligible to make an IRA contribution, you must earn income, and that income must meet IRS rules. The rules specify limits for higher income earners, which may decrease the allowable contribution, disallow it entirely, or affect how much of the contribution is deductible. A full breakdown of the rules can be found at the IRS website: <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits>.

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The IRS also sets maximum IRA contribution limits. Assuming no other limiting factors apply, the current guidelines allow contributions of \$6,000 per year in 2020 and 2021 to a Traditional or Roth IRA. Individuals age 50 or older may contribute an additional “catch-up” amount of \$1,000 for a total of \$7,000 annually. Generally, you can make your contribution up to the tax filing deadline for the year. While that is normally April 15 of the following year, the 2019 tax filing and IRA contribution deadlines were extended to July 15, 2020, due to the COVID-19 pandemic. We have yet to hear from the IRS if it will grant a similar extension for 2020. It’s important to check the IRS rules annually for updates, but we suggest more frequent checks during these uncertain times.

INVESTING FOR YOUR FUTURE

Once you determine an IRA is right for you, you must find an institution approved by the IRS to open IRAs. Many people look to an investment advisor for help getting their accounts set up. Other options include banks, federally insured credit unions, and savings & loan associations.

You will be presented with different investment options for your IRA savings depending on where you go to open your account. The most common types of investments are stocks, bonds, exchange-traded funds, and mutual funds, but there are many other investment vehicles available to you, which is one reason to work with an independent financial advisor to help you get your IRA started.

An IRA is an excellent way to invest for your future, but is typically only one piece of your financial puzzle. If you’re interested in knowing more, contact an HBKS® financial professional for more information.

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