IRAs — The Rules Have Changed, But Not the Reasons to Invest

Adrienne Horen

There was a time when retirement was a subject, not an issue. You worked—you retired. Retirement was a fait accompli. The only discussions that occurred during the "–" period concerned how you were going to spend your well-earned leisure time. Today, the focus is no longer simply on plans for the future, but planning for the future.

Every day, we are reminded of the importance of saving for tomorrow and of early preparation. We witnessed the political battles waged over Social Security. But for all of the talk, the most telling comment on the state of retirement is a simple statistic: according to the Profit Sharing/401(k) Council of America, over $14 trillion is set aside in the U.S. for retirement in addition to Social Security.

Everyone is concerned about being prepared for retirement. Fortunately, individuals have had many ways to save, including Individual Retirement Accounts (IRAs), 401(k)s and other defined benefit plans. While no system is perfect, a system upon which so many rely for their future financial comfort and security must be both robust and address the varying needs of a broad constituency.

In August, President Bush signed legislation, the Pension Protection Act of 2006, one of the most significant reforms of the nation's pension laws in the past 30 years. Its purpose is to help redefine and revise many key elements and rules regarding retirement savings programs.

IRAs—The Basics

Before considering the changes, it is important to understand, in general terms, the features and benefits of IRAs. IRAs allow investors to save for retirement with varying degrees of tax advantages. Individuals can choose from a Traditional or Roth IRA, while couples can take advantage of a Spousal IRA.

A Traditional IRA allows individuals under the age of 70 ½ to annually contribute up to $4,000 of earned income. Investments grow tax-deferred—you begin paying taxes once you reach 70 ½ and begin taking out funds.1 If you need access to your funds, you can begin making withdrawals prior to age 59 ½ (although you will incur a 10% tax penalty).

A Roth IRA differs in that it allows individuals to save for retirement using after-tax dollars.2 Contributions are not deductible, but the appreciation is tax-free—you pay no income tax on your gains and keep more of what you earn.3 Spousal IRAs are for married couples with one spouse who does not work. The working spouse may contribute up to $4,000 per year to an IRA, in the name of the non-working spouse, and up to $4,000 per year to his or her own IRA. As a result, a couple may contribute 100% of income up to a maximum of $8,000 per year.

IRAs—The Changes

At its heart, the Pension Protection Act of 2006 targets employers, requiring them to bolster their pension plans. However, many provisions are aimed at improving savings opportunities for individuals and, for married couples, spouses. One of the Act's most intriguing enhancements is that fiduciary advisors are now allowed to provide investment advice to owners and beneficiaries of IRAs.

Changes for Individuals and Couples

The phasing out of cost-of-living adjustments to income limits on contributions to a Roth IRA will allow more taxpayers to make qualified Roth IRA contributions.

In 2006 and 2007, individuals 70 ½ and over can exclude up to $100,000 a year of distributions from IRAs (including Roths IRAs) that are directly paid by the IRA or Roth IRA trustee to a qualifying charity. However, if the exclusion is chosen, the donated amount cannot be deducted as a charitable contribution.

The phasing out of cost-of-living increases to income limits on an IRA when an individual (or spouse) is an active participant in an employer sponsored plan will allow for more active participants to make deductible IRA contributions.

For distributions made after 2006, non-spouse beneficiaries of a retirement plan account will be able to make rollovers to inherited IRA accounts. This gives beneficiaries much-needed flexibility when inheriting plan accounts from parents and other non-spousal relatives.

General Changes

The Act provides for more rollover options for after-tax contributions to retirement plans. Beginning in 2007, contributions can be rolled over to another retirement plan or to a tax sheltered annuity, if the transfer is made via a direct rollover and the receiving plan or annuity separately accounts for the after-tax contributions.

After 2007, distributions from retirement plans, tax-sheltered annuities and governmental 457 plans can be directly rolled over into a Roth IRA, subject to the same rules that apply to rolling over a Traditional IRA into a Roth IRA.

Changes to IRAs by the Economic Growth and Tax Reconciliation Act of 2001 are now permanent, including "catch-up" contributions to IRAs after reaching the age of 50, increases in the maximum Traditional and Roth IRA contributions and widened rollover choices.

IRAs —The Time Is Now

IRAs have always been a good choice for investors seeking to prepare for retirement with the benefit of tax advantages to help them keep more of what they save. With the changes discussed above, IRAs are now even more attractive. The rules of IRAs have changed; but the "golden rule" of investing remains a constant: preparing today will help provide for a more comfortable and secure financial tomorrow.

1 Minimum withdrawals are required at age 70 1/2.

2 Qualified Roth IRA contributions may be subject to state and local taxation.

3 Roth IRA eligibility limitations are based on adjusted gross income (AGI) and are not affected by participation in a pension plan. If you have under $110,000 (or $160,000 for married joint filers) of Modified Adjusted Gross Income (MAGI), you can open a Roth IRA by making after-tax contributions of up to $4,000 a year.

Adrienne Horen

Vice President / Investments

Janney
Serving Investors Since 1832

215.665.6672 • ahoren@jmsonline.com
www.jmsonlinefc.com/askadrienne

Janney Montgomery Scott LLC
1801 Market Street • Philadelphia, PA 19103
Member NYSE • NASD • SIPC