MONEY MANAGEMENT

Using IRAs As Part Of Your Retirement Plan

RENO — Even if you have a modest income, you can build a sizable retirement nest egg by setting aside small sums of money each year in an Individual Retirement Account (IRA). According to the Nevada Society of CPAs, many people overlook the value of IRAs because of the complex rules governing whether or not contributions are tax-deductible, and how and when IRA funds can be withdrawn. However, CPAs say IRAs can be a valuable part of any retirement plan.

DEDUCTIBLE VS. NONDEDUCTIBLE CONTRIBUTIONS

Many taxpayers can deduct their IRA contributions. If neither you nor your spouse actively participate in an employer's qualified retirement plan, you can contribute and deduct annually up to $2,000 or 100 percent of your compensation, whichever is less. If your spouse works and is earning at least $2,000, you can contribute and deduct an additional $2,000, for a total of $4,000. If you have a non-working spouse, your total allowable deduction increases to $2,250.

If you or your spouse are covered by a qualified retirement plan, you may still be able to deduct an IRA contribution. A married couple with adjusted gross income (AGI) below $50,000 and a single person with an AGI below $35,000 are eligible for a full or partial deduction.

Even if you don't qualify to deduct your IRA contributions, an IRA can be a valuable retirement-planning tool because your earnings accumulate on a tax-deferred basis. Since you are not required to pay taxes on your earnings as they grow, your money may compound faster than it would in taxable vehicles.

IRA WITHDRAWALS

Strict rules apply to taking distributions from your IRA. In most instances, if you withdraw money from your account before you reach age 59 1/2, a 10-percent early-distribution penalty is added to the taxes that are due.

You can avoid the 10-percent early-distribution penalty by withdrawing your money in the form of an annuity — that is, a series of payments spread over your lifetime. You can establish the annuity at any age. With an annuity, you must make roughly equal withdrawals at least annually based on your life expectancy, or the joint life expectancies of you and your beneficiary.

Keep in mind that once you choose an annuity, you'll need to stick with your decision. The payment schedule must be in effect for at least five years or until you turn age 59 1/2, whichever is later. If you discontinue or change your schedule, in most instances, you will be subject to the 10-percent penalty.

Between ages 59 1/2 and 70 1/2, you can withdraw as much or as little money as you need from your IRA, without paying any penalty. However, you should bear in mind that the portion of your distributions that is made up of deductible contributions and earnings is included in your gross income and taxed at the current tax rate.

By April 1, following the calendar year in which you reach age 70 1/2, you must begin withdrawals, regardless of whether you have retired. In subsequent years, you are required to take a certain minimum distribution, based on your life expectancy, your account balance and other factors, no later than December 31.

TRANSFERRING RETIREMENT ACCOUNTS

If you're not yet ready or tap into your retirement income but you're dissatisfied with your IRA's performance, you can transfer your IRA balance to a different trustee. When you make trustee-to-trustee transfers, no money is distributed to you and the transfer is tax-free. In addition, there are no restrictions on how often you can make such a transfer.

If you leave your job and receive a lump sum distribution from a pension or profit-sharing plan, you can avoid paying taxes on the funds by contributing them to your IRA within 60 days. The tax rules allow you to make this kind of rollover once in any one-year period, which begins on the date you receive the distribution. However, CPAs point out that when eligible rollover distributions are paid to you, as opposed to a trustee, you are subject to a 20-percent withholding tax, even if the money is re-deposited within the 60-day period.

Additional rules — including some penalties — apply to certain withdrawals and transfers of IRA assets. To make the most of your IRA savings, be sure to familiarize yourself with these rules.

Money Management is a public service announcement on personal finance prepared and distributed by certified public accountants. Nevada Society of Certified Public Accounts 5250 Neil Road, Suite 205, Reno, Nevada 89502.