Understanding Traditional and Roth IRAs

When it comes to retirement, your future is in your hands – not solely in the hands of the organization that employs you. While the military offers Thrift Savings Plan accounts to all active duty servicemembers, not all civilian employers offer sponsored retirement plans. Fortunately, when your employer does not offer a sponsored retirement plan, saving for retirement as an individual is still possible using personal investment accounts.

If you are not covered by a retirement plan through work, you may want to consider opening an Individual Retirement Account, or IRA, to prepare for your future. Even if you do have access to an employer-sponsored retirement plan, you can open a separate IRA at any time provided you are earning income. This type of account can supplement other retirement funds and your savings. While there are four types of IRAs, the two most common and open to individuals who wish to save earned income are traditional and Roth IRAs.

> **Note:** You can learn about the other two IRAs, SEP IRAs and SIMPLE IRAs, which are open to small business owners and self-employed individuals, here.

Traditional and Roth IRAs are funded with your personal contributions and you are responsible for all associated fees. Money contributed to an IRA can be invested in a number of products, including stocks, bonds, mutual funds, and exchange-traded funds (ETFs).

Traditional IRAs

Traditional IRAs are available to individuals who receive any amount of earned income. If you open a traditional IRA, earnings on the money deposited grow tax-deferred, meaning that you are only required to pay taxes on the earnings *when you receive distributions in retirement*. As explained below, contributions may or may not be tax-deferred depending on your income level.

Traditional IRAs have a $6,500 annual contribution limit. If you are over age 50, you can contribute an additional $1,000 in catch-up contributions.

Contributions to a traditional IRA may be tax-deductible during the year of the contribution, thereby lowering your taxable income. However, this depends on (1) whether you have a retirement plan through your employer – or your spouse through theirs – and (2) your income level.

If you are covered by a retirement plan through your employer:

- If your IRS filing status is single or head of household and your modified adjusted gross income (MAGI) is less than $83,000, you can deduct at least part of your IRA contribution.
- If your IRS filing status is married filing jointly or qualifying widow(er) and your MAGI is less than $136,000, you can deduct at least part of your IRA contribution.
- If your IRS filing status is married filing separately and your MAGI is less than $10,000, you can deduct part of your IRA contribution.

If you are *not* covered by a retirement plan through your employer:

- If your IRS filing status is single, head of household, or qualifying widow(er), you can fully deduct your IRA contribution.
- If your IRS filing status is married filing jointly or married filing separately *and* your spouse is not covered by a retirement plan through their employer, you can fully deduct your IRA contribution.
- If your IRS filing status is married filing jointly, your spouse is covered by a retirement plan through their employer, and your MAGI is less than $228,000, you can deduct at least part of your IRA contribution.
- If your IRS filing status is married filing separately, your spouse is covered by a retirement plan through their employer, and your MAGI is less than $10,000, you can deduct part of your IRA contribution.

When you begin to withdraw money in retirement, you will be required to pay taxes on the amount of any contributions that you originally deducted from your taxes. You will also be required to pay taxes on all earnings withdrawn from the account. Note that the total values of all traditional IRAs you own are aggregated together and subject to required minimum distributions once you reach age 73.

If you did not take a deduction when you originally contributed funds to your traditional IRA and filed Form 8606 with your tax returns, you will not have to pay taxes on those withdrawals. However, you will still have to pay taxes on earnings withdrawn from the account.

Roth IRAs

A Roth IRA is only available to individuals who meet IRS income guidelines. This type of account allows you to contribute after-tax dollars and therefore does not affect your taxable income at the time of contribution. However, because you already paid taxes on the contributions, your future retirement distributions are tax-free. Roth IRAs are not subject to required minimum distributions.

At their highest, Roth IRAs have a $6,500 annual contribution limit, but the limit may be lower depending on your income. If you are over age 50, you can contribute an additional $1,000 in catch-up contributions.

- To be eligible to contribute to a Roth IRA, you must have an income below $153,000 if you are filing as single or $228,000 if you are married filing jointly.
- To contribute the full $6,500, you must have an income below $138,000 if you are filing as single or $218,000 if you are married filing jointly.

Provided your account is over five years old and you are over the age of 59 ½ years old, you will not have to pay any taxes or penalties on your withdrawals. Roth IRAs are not subject to required minimum distributions.

A few notes about IRAs:

- You can contribute to multiple IRAs in a single year, but combined contributions cannot exceed the annual limit. In other words, you can contribute to both a traditional and a Roth IRA, but you cannot contribute more than $6,500 total.
- Loans are not permitted from traditional or Roth IRAs.
- Withdrawals may be subject to penalties:
    - If you withdraw money from your traditional IRA before you reach age 59 ½ you will have to pay a 10% penalty.
    - If you withdraw your *contributions* from a Roth IRA, you will not have to pay taxes or a 10% penalty because this money was already taxed at the time of deposit. However, if you withdraw any of your Roth IRA *earnings* before reaching age 59 ½, you may be taxed and penalized. To withdraw earnings without having to pay taxes or penalties, at least five years must also have elapsed since you first contributed to a Roth IRA, regardless of your age.
- Traditional IRAs can legally be rolled over into another form of IRA or into a TSP account, 401(k), 403(b), or 457(b). However, your employer-sponsored plan must accept incoming transfers. A Roth IRA can only be rolled over into another Roth IRA account because of the account's tax status.

Whether you have access to an employer-sponsored retirement account depends on your employer, but as long as you earn income, you are able to open a traditional and/or Roth IRA. Keep in mind that if you are married filing jointly but your spouse does not work, you can still contribute to an IRA in their name, increasing your overall retirement savings potential.

IRAs provide you with the opportunity to save for retirement without relying on your employer – and you can start contributing when you're young. A minor can open an IRA as soon as they file a tax return that includes income earned from employment, so their first part-time job presents an opportunity to save for the future. If you have questions about retirement accounts, how IRAs can supplement or interact with TSP accounts, or retirement in general, Navy Mutual's educators can be reached by phone at 888-298-4442 or by email at Education@NavyMutual.org.