

While you're on the road to retirement, the best way to save is through a work-based plan, like a 401(k). If you don't have a plan or if you are looking for additional ways to save for retirement, an Individual Retirement Account (IRA) is the place to start.

An IRA is similar to a savings account, but there are two big differences. First, IRAs provide tax advantages to encourage you to save for retirement. Second, in addition to cash, you can put a wide variety of investments—including stocks, bonds and mutual funds—into an IRA so your money has a chance of growing at a better rate.

As long as you meet some limits on your income and on the amount you contribute, you can add to the account every year. However, most years both the income and contribution limits change. So before you make a contribution, check www.irs.gov or with your financial institution for the most current information. In general, you must be earning income from a job to contribute to an IRA. However, a family can also save more money for retirement by opening an IRA for a spouse who does not have earnings from a job, and contributing to it from other income.

How to Set Up an IRA

- Open one through your bank, a brokerage house, a credit union, or a life insurance company.
- Before you open an account, compare fees. Choose an account with low fees to maximize your savings.
- Make an initial deposit, which may be anywhere from \$100 to \$1,000.
- Contribute through a payroll deduction if you can, or through a regular transfer from your checking account. You could also choose to make occasional contributions.
- Ask what investments are available before you open an account to make certain you have the options you want.

Investment Options

The IRA itself is simply an account. You have to choose how to invest your contributions and earnings.

- Banks typically offer IRA investments in certificates of deposit or money market funds.
- Other financial institutions typically offer stock and bond mutual funds and individual stocks and bonds, as well as other investment choices.

Decide how to invest your contributions based on these factors:

- Your current age;
- When you expect to retire; and
- Your comfort level with risk relative to your savings goal.

Traditional vs. Roth

There are two main types of IRAs—the traditional and the Roth. The main difference between them is that when you contribute to a traditional IRA, you receive an immediate deduction on the same year's taxes. With a Roth, you must pay income tax on the money you contribute each year. But when you retire and start taking money out of a Roth, you won't have to pay taxes on the withdrawals.

See the chart for some factors to consider when deciding whether to open a traditional or a Roth IRA.

Traditional IRA	Roth IRA
<p>Eligibility to contribute</p> <ul style="list-style-type: none"> You must be getting paid for working and be under age 70½. Spouses of workers may also contribute within certain income limits. 	<ul style="list-style-type: none"> You're fully eligible at any age if you meet certain income limits that change often. Spouses of workers may also contribute within certain limits. Check Publication 590 at www.irs.gov for current limits.
<p>Income tax treatment</p> <ul style="list-style-type: none"> IRS allows you to contribute \$4,000 each year (\$5,000 if you are 50 or older). Contributions are deductible from your taxable income. You must pay income taxes on money you withdraw from the IRA. 	<ul style="list-style-type: none"> IRS allows you to contribute up to \$4,000 each year (\$5,000 if you are 50 or older). You may not take a tax deduction on contributions when they are made. You pay no federal tax on earnings and interest, provided withdrawals meet certain rules.
<p>Penalty for early withdrawal</p> <ul style="list-style-type: none"> 10% penalty for early withdrawal before age 59½ with certain exceptions. 	<ul style="list-style-type: none"> 10% penalty for early withdrawal on investment earnings during the Roth's first 5 years or before age 59½ with certain exceptions. No penalty on withdrawals after the IRA's first 5 years if you are over 59½.
<p>Penalty for late withdrawal</p> <ul style="list-style-type: none"> 50% penalty for not taking minimum required withdrawals each year at age 70½ or older. No penalty on early withdrawals for college tuition (up to \$10,000); first-time home purchase; certain medical expenses; disability; or if you inherit an IRA. 	<ul style="list-style-type: none"> No penalty. Minimum withdrawals are not required. Withdrawals are tax-free at any time if withdrawal is for college tuition (up to \$10,000), first-time home purchase, certain medical expenses, disability, or if you inherit the IRA.
<p>401(k) rollover options</p> <ul style="list-style-type: none"> You can roll your traditional IRA into your new employer's 401(k). You can roll your 401(k) into a traditional IRA. 	<ul style="list-style-type: none"> You can roll your Roth IRA into your new employer's 401(k). You can roll your 401(k) into a Roth IRA.

Rollover IRAs

If you have a 401(k) or other retirement account at work, when you leave your job you must decide what to do with the money in the account. If you simply withdraw the money and plan to spend it, you'll have to pay income tax on it. If you're under 59 ½, you'll probably have to pay a penalty for early withdrawal.

To keep the tax benefits and allow the money to continue to grow for your retirement, often the best option is to transfer the 401(k) money directly into an

IRA Rollover account in a bank or other financial institution. This allows you to choose how to invest the money. It also frees you from having to keep up with changes and new information about your account when you are no longer working for that employer. Typically you must move the money into the rollover IRA within 60 days of leaving your job. So don't put off choosing a financial institution to help you make the switch.

Your To-Do List

- Before putting money into an IRA, contribute the maximum amount to your 401(k) or similar work-based retirement account.**
- For an overview of the types of IRAs and how they work, visit the retirement planning section of AARP's website, www.aarp.org/money/work/articles/individual_retirement_accounts.html.**
- Compare traditional and Roth IRA options.** Use Morningstar's IRA comparison calculator at <http://screen.morningstar.com/IRA/IRAcalsculator.html> to figure out which type would likely provide you with more retirement income.
- Use the same Morningstar comparison calculator to decide if it makes financial sense for you to roll money from your traditional IRA into a Roth.**
- Ask about fees and investment options before choosing a provider, and compare.** Some comparisons are available on The Motley Fool website, www.fool.com/ira/ira01.htm.
- For details on how different types of IRAs work, read IRS Publication 590, "Individual Retirement Arrangements" at www.irs.gov/publications/p590.**

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