

Rules of the Roth IRA

Unlike the traditional IRA, contributions to a Roth IRA are nondeductible regardless of your income level or participation in a company-sponsored retirement plan.

Your contributions are limited to \$5,000 a year (\$10,000 for couples) in 2009. The contribution limit begins to decline or "phase out" for single taxpayers with adjusted gross incomes (AGIs) of more than \$105,000 and for married couples filing jointly with AGIs of more than \$166,000. Individuals with modified AGIs in excess of \$120,000 (\$176,000 for married couples filing jointly) are not eligible to contribute to a Roth IRA. Married taxpayers filing separately are allowed to contribute to a Roth IRA, but may not qualify under income guidelines. An individual's total contributions to all IRAs, traditional and Roth, may not exceed the annual contribution limit (\$5,000 in 2009).

Contribution limits may increase in the years ahead. The annual contribution limit for a Roth IRA is \$5,000 in 2009. In the future, the annual contribution limit will be adjusted for inflation. Americans age 50 or older are also able to make so-called "catch-up" contributions to a Roth IRA. The allowable catch-up contribution is \$1,000 per year but is not adjusted for inflation.

Your contributions to a Roth IRA may continue beyond age 70½. You are not required to start taking distributions from a Roth IRA at age 70½, as you are with a traditional IRA, and you can continue to contribute as long as you have earned income. When a Roth IRA owner dies, however, his or her heirs must adhere to the same minimum-distribution rules that apply to regular IRAs.

Qualified distributions from a Roth IRA are tax free. While your contributions to a Roth IRA are never tax deductible, your distributions may be tax free if you have owned the Roth IRA for at least five years and:

- You are at least 59½ years old; or
- Your withdrawal of up to \$10,000 (lifetime limit) is applied to a first-time home purchase; or
- You die or become permanently disabled.

You may qualify for the "first-time home purchase" if you have not owned a home for at least two years before the date on the purchase contract or the date when construction started. You, your spouse, or a descendant or ancestor of either may qualify as the buyer.

The taxable portion of a nonqualified distribution is subject to a 10% tax penalty. If you make withdrawals that do not meet the rules for a qualified distribution, you'll owe taxes on all or a portion of the withdrawal. You may also pay a 10% penalty tax on the taxable portion of the withdrawal, if you are under age 50 ½.

Penalty-free withdrawals are permitted for qualified education expenses. If you are under age 59½, you may withdraw funds penalty free to pay for qualified education expenses for yourself or family members regardless of how long you've held the account. You will have to pay income tax on the taxable portion of the distribution, however.

Retirement plan "rollovers" are permitted. If you are changing jobs or retiring, you can roll over funds from an employer retirement plan, such as a 401(k) account, directly to a Roth IRA. In the past, you could do this only if your workplace retirement account was a Roth-style plan. But since 2008, direct rollovers from a non-Roth plan have been allowed. The rollover is treated as a conversion, with income tax due on pre tax contributions and earnings.