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Retirement and Taxes: Understanding IRAs

Individual Retirement Arrangements, or IRAs, provide tax incentives for people to make investments that can provide financial security for their retirement. These accounts can be set up with a bank or other financial institution, a life insurance company, mutual fund, or stockbroker.

Here's a basic overview to help people better understand this type of retirement savings account.

- **Contribution**. The money that someone puts into their IRA. There are annual limits to contributions depending on their age and the type of IRA. Generally, a taxpayer or their spouse must have earned income to contribute to an IRA.
- **Distribution**. The amount that someone withdraws from their IRA.
- **Withdrawals**. Taxpayers may face a 10% penalty and a tax bill if they withdraw money before age 59 ½, unless they qualify for an exception**.**
- **Required distribution**. There are requirements for withdrawing from an IRA:
    - Someone generally must start taking withdrawals from their IRA when they reach age 70½.
    - Per the 2019 SECURE Act, if a person's 70th birthday is on or after July 1, 2019, they do not have to take withdrawals until age 72.
    - Special distribution rules apply for IRA beneficiaries.
- **Traditional IRA**. An IRA where contributions may be tax deductible. Generally, the amounts in a traditional IRA are not taxed until they are withdrawn.
- **Roth IRA**. This type of IRA that is subject to the same rules as a traditional IRA but with certain exceptions:
    - A taxpayer cannot deduct contributions to a Roth IRA.
    - Qualified distributions are tax-free.
    - Roth IRAs do not require withdrawals until after the death of the owner.
- **Savings Incentive Match Plan for Employees**. This is commonly known as a SIMPLE IRA. Employees and employers may contribute to traditional IRAs set up for employees. It may work well as a start-up retirement savings plan for small employers.
- **Simplified Employee Pension**. This is known as a SEP-IRA. An employer can make contributions toward their own retirement and their employees' retirement. The employee owns and controls a SEP.
- **Rollover IRA**. This is when the IRA owner receives a payment from their retirement plan and deposits it into a different IRA within 60 days.

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