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INVESTING

INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)



OUR MISSION

The mission of The USAA Educational Foundation is to help consumers make informed decisions by providing information on financial management, safety concerns and significant life events.



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2 WHAT IS AN IRA?

IT IS UP TO YOU
TO ESTABLISH
THE FINANCIAL
FOUNDATION
FOR ALL OF THE
THINGS YOU WANT
TO DO WHEN YOU
ARE NO LONGER
EMPLOYED.

When envisioning retirement, many individuals imagine traveling, enjoying hobbies and spending quality time with family and friends.

The truth is, a dream retirement takes careful planning and thought. It is up to you to establish the financial foundation for all of the things you want to do when you are no longer employed.

Regardless of your age, you can start planning for your retirement now with one of the best save-for-tomorrow tools at your disposal: an **IRA**, or **Individual Retirement Account**.

Simply put, an IRA is a tax-advantaged account that can hold many different types of investments: stocks, bonds, mutual funds, annuities, certificates of deposit (CDs) and more.

Once you open an IRA, your money grows tax deferred over time. When you are ready to access your money, you can convert your IRA into a steady stream of retirement income.

There are two basic types of IRAs — traditional and Roth — and each are tax-advantaged savings plans that allow you to invest a maximum amount each year for retirement.

- With a **traditional IRA**, you may be able to deduct your contribution from your taxable income, thus reducing current federal income taxes. This depends on your income and if you are covered by a retirement plan at work. While your money grows, taxes are deferred. You will be subject to ordinary federal income taxes when you withdraw the money, generally at retirement.
- With a **Roth IRA**, you cannot deduct your contribution from your income for federal income tax purposes. However, qualified withdrawals of earnings are free of federal income tax. If you withdraw earnings before the account has been open at least 5 years or before age 59½, you are generally subject to federal income taxes and a 10 percent penalty on the amount of earnings withdrawn.

Contributing To An IRA

IRAs were created to help Americans save for retirement. Who may contribute? Almost anyone, as long as their earned income for the year equals or exceeds the amount of their contribution. Married couples may each contribute to an IRA, even if only one has an income, as long as the working spouse's earned income is large enough to cover the contributions for both.

Because contributions to Roth IRAs are made with after-tax income, your contributions may be withdrawn free of federal income tax at any time — and you do not have to pay the money back. That makes the money inside a Roth IRA “liquid,” or easily accessible (although it may be subject to market risk).

To illustrate the tax advantage of a Roth IRA, assume that you have made \$50,000 in contributions to a Roth IRA that has increased in value to \$75,000. Because the \$50,000 was contributed from your after-tax income, you may withdraw up to the entire \$50,000 completely tax-free, regardless of your age.

Remember, the downside to making early withdrawals from your Roth IRA is that less of your retirement money will benefit from growing free of federal income tax.

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4 TRADITIONAL VS. ROTH IRAs

Which Is Best For You?

When it comes to IRAs, you have a choice to make. Most often, that choice means deciding which of the two most basic IRAs best meets your needs: the **traditional IRA** or the **Roth IRA**.

Traditional IRA

- You may be able to deduct your contribution from your taxable income, thus reducing current federal income taxes.
- While your money grows, federal income taxes are deferred.
- You may add funds to your traditional IRA any time prior to age 70½, as long as you (or your spouse, if you file a joint tax return) earned enough to cover the year's contributions.
- You may have a variety of investments within your IRA such as stocks, bonds, mutual funds, annuities or certificates of deposit (CDs).
- Contributions must generally be made by the due date for filing your federal income tax return not including extensions (typically April 15) to count as a contribution (and if you are eligible, a deduction) for the previous tax year. In 2009 and 2010, the contribution limit for those under age 50 is \$5,000. For those ages 50 and over, the limit is \$6,000.

Roth IRA

- Contributions to a Roth IRA are made with after-tax income, so you can withdraw your contributions at any time without penalty or federal income tax.
- Qualified withdrawals of earnings are federal income tax-free and penalty free if held for 5 years and withdrawn after age 59½.
- You may continue to contribute to a Roth IRA as long as your adjusted gross income is below certain amounts.
- You may have a variety of investments within your IRA such as stocks, bonds, mutual funds, annuities or CDs.
- In 2009 and 2010, the contribution limit for those under age 50 is \$5,000. For those ages 50 and over, the limit is \$6,000.

TRADITIONAL VS. ROTH

	TRADITIONAL IRA	ROTH IRA
Who May Contribute	All workers under age 70½ by the end of the calendar year. Spousal IRA — spouses under age 70½ by the end of the calendar year if tax filing status is married, filing jointly.	No age limit; however, if married and filing jointly or qualified widow(er), contributions are phased out for modified adjusted gross income (MAGI) from \$167,000 to \$177,000 and if filing single, from \$105,000 to \$120,000.
2009/2010 Contribution Limits	Individual: \$5,000 Married filing jointly: \$10,000 (up to \$5,000 each)	Individual: \$5,000 Married filing jointly: \$10,000 (up to \$5,000 each)
2009/2010 Catch-up Contribution	If you are age 50 or older, you may make an additional contribution of \$1,000.	If you are age 50 or older, you may make an additional contribution of \$1,000.
Deadlines	Generally April 15 to contribute for the previous tax year.	Generally April 15 to contribute for the previous tax year.
Federal Income Tax Deductible	May be able to deduct your contribution, subject to modified adjusted gross income (MAGI) limits if you are covered by an employer plan.	No income tax deduction.
Tax-Advantaged Growth	No taxes on distributions until you withdraw them.	Earnings grow potentially free of federal income tax and may be withdrawn free of federal income tax after age 59½ if you have held the account for at least five years.
Required Distributions	Distributions must begin by April 1 of the year after turning age 70½.	No mandatory age for taking distributions during account owner's lifetime.
401(k) Rollovers	Once you are eligible to take a distribution from your 401(k), you may roll it directly into a traditional IRA.	Eligible employees participating in traditional 401(k)s or other qualified plans, 403(b) plans, and governmental 457(b) plans can roll their distributions over into a Roth IRA. This rule applies to distributions received after December 31, 2007, and only applies to direct (trustee to trustee) rollovers — 60 day indirect rollovers are not allowed.

TRADITIONAL VS. ROTH (CONTINUED)

	TRADITIONAL IRA	ROTH IRA
Withdrawals	<ul style="list-style-type: none"> • After age 59½, withdrawals are not subject to federal income tax penalties. Withdrawals may be subject to federal and state income taxes. • Withdrawals prior to age 59½ may be subject to federal and state income taxes, plus a 10 percent federal income tax penalty may apply. 	<ul style="list-style-type: none"> • Contributions may be withdrawn at any time without penalty. • Early withdrawals may be subject to federal and state income taxes plus a 10 percent federal income tax penalty.
Qualified Early Withdrawals	<p>You may begin taking withdrawals without any penalties when you reach age 59½. In addition, penalty-free withdrawals are allowed if:</p> <ul style="list-style-type: none"> • You are a first-time homebuyer (\$10,000 lifetime limit). • You are using the withdrawal to pay for certain higher education expenses. • Certain conditions are met for unemployment or qualifying medical expenses. • The distribution was a result of your disability. 	<p>Your principal and earnings may be withdrawn completely tax-free if the Roth IRA has been open for 5 or more years and at least one of the following conditions are met:</p> <ul style="list-style-type: none"> • You are age 59½ or older. • You are a first-time homebuyer (\$10,000 lifetime limit). • You are disabled. • Withdrawals are made by your beneficiary after you die.
This IRA May Be Right For You If	<ul style="list-style-type: none"> • You do not qualify for a Roth IRA because of your income level. • You expect to be in a lower federal income tax bracket in retirement. 	<ul style="list-style-type: none"> • You anticipate remaining in your current tax bracket after retirement. • You expect that when you retire, you will be in a higher tax bracket.

When Should You Open An IRA?

It is generally not too early to plan for retirement, and that means it is not too early to open an IRA.

Whether you choose a traditional IRA or a Roth IRA as your retirement investment account, you can benefit from tax-deferred compounding of your earnings over the long term. What is compounding? It is when earned interest is added to the principal which earns additional interest on itself. Over time, compounding can produce significant growth.

For example, if you invested the contribution limit of \$5,000 each year for 20 years, the total contribution would be \$100,000. If you put \$5,000 per year into an account earning 8 percent annually and allow it to grow undisturbed for 20 years, your \$100,000 investment will grow to \$247,115. After 30 years, it will reach \$611,730.

Where should you open your IRA? There are many places to open an IRA. How do you choose the one that is right for you?

- **Banks** often accept small accounts and may charge minimal or no fees, making them a good choice for small investors. But a bank probably will not offer as many investment alternatives as a mutual fund company or brokerage firm.
- **Mutual fund companies** offer a variety of investment options, so you may be able to invest your IRA in different types of funds, creating a personalized mix that is right for you. You may even be able to move some or all of your IRA from one fund to another when your investment goals change.
- **Brokerage firms** offer IRA accounts and allow you to design your own portfolio. In addition, brokers make it possible to own mutual fund shares as well as individual stocks.
- **Insurance companies** may be appealing to you if you would like to invest your IRA in an annuity or another of the insurer's offerings.

Making The Decision

When making a choice of IRA providers, be sure to ask about:

- Fees. There may be start-up fees, annual maintenance fees and fees for changing your investments or withdrawals.
- The cost of transferring your account to another provider.
- Automatic deductions and limits.
- Investment options. For example, can you invest in stocks, bonds and mutual funds?

All of these issues are important, because they can significantly affect the earning power of your IRA.

8 WHAT IS A ROLLOVER?

Most workers change jobs several times over the course of their careers. If you leave a job for any reason, you will probably have to make a decision about what to do with the savings you have built in a qualified retirement plan, such as a 401(k).

Some companies allow you to leave money in their plans until you reach retirement age. Others require you to move your money. You could take a lump sum payout, but that involves federal income taxes and penalties. Or, you could roll the money over into an IRA, maintaining the federal income tax-deferred status of your retirement savings and avoiding federal income taxes and penalties.

When rolling money over from a qualified plan, you can place it into an existing IRA or into a new, separate IRA. It may be best to keep the rollover separate. You may someday want to move the funds to another employer-sponsored plan, and some companies do not allow the rollover of combined assets. Although you can make contributions to a rollover IRA, doing so may mean you cannot roll the IRA into a new employer-sponsored plan.

IRA Withholding Tax And Direct Rollovers

IRAs were created to help save for retirement, and the laws surrounding them were designed to discourage individuals from withdrawing money early and diminishing the power of compound interest.

If you change jobs or retire and take an early withdrawal from your 401(k) retirement savings, the company is required to withhold 20 percent of your 401(k) savings for federal income tax purposes. This applies only to qualified retirement plans, including 401(k) plans, 403(b) plans and other profit-sharing plans.

You can avoid the 20 percent IRA withholding law with a 100 percent direct rollover into your IRA. Simply request your prior employer pay all of your retirement plan distribution directly into your rollover IRA account.

What if your employer sends you a check for your retirement assets and deducts the 20 percent income tax? You can recapture the withheld amount if you deposit your retirement assets into a rollover IRA within 60 days. The deposit must equal the amount of your distribution, plus the 20 percent withheld by your employer. If you do not add the withheld amount, it will be considered a distribution and taxed as ordinary income. In addition, the amount may also be subject to a 10 percent early withdrawal penalty.

By funding your rollover IRA within 60 days with 100 percent of your retirement plan payout, you will receive the 20 percent withheld by your employer as a tax credit when you file your federal income tax return.

Remember: Before making any decision about a pension distribution, discuss your strategy with your financial planning professional.

Can you borrow money from your IRA? No. Internal Revenue Service (IRS) rules do not allow borrowing from an IRA. IRS rules only allow distributions, which may be taxable for federal income tax purposes.

You could use a 60-day rollover to temporarily take funds from your IRA. But if you do not redeposit the money in a retirement account within 60 days, you are liable for federal income taxes on the amount withdrawn, plus a 10 percent penalty if you are under age 59½.

Traditional IRA conversion. A key change for 2010 is the elimination of the \$100,000 income limit for the conversion of a traditional IRA to a Roth IRA. What this means is that if an individual's modified adjusted gross income (MAGI) exceeds the IRS level to contribute to a Roth IRA in 2010, they can still contribute to a traditional IRA and immediately convert the traditional IRA over to a Roth IRA. The amount converted may be taxable for federal income tax purposes.

**REMEMBER:
BEFORE MAKING
ANY DECISION
ABOUT A PEN-
SION DISTRIBU-
TION, DISCUSS
YOUR STRATEGY
WITH YOUR FINAN-
CIAL PLANNING
PROFESSIONAL.**

10 OTHER TYPES OF IRAs

Traditional and Roth IRAs are the best-known IRA options, but there are other types of IRAs.

- A **Simplified Employee Pension IRA (SEP IRA)** is a retirement plan established by employers, including self-employed individuals. With a SEP, employers make tax-deductible contributions of up to 15 percent of compensation on behalf of eligible employees. Participating employees must establish a traditional IRA to which the employer deposits SEP contributions. Employees do not pay federal income taxes on SEP contributions, but the contributions are taxed upon distribution.
- **SIMPLE IRAs** were designed to make it easier for businesses with less than 100 employees to offer workers a tax-advantaged, company-sponsored retirement plan. SIMPLE plans can be funded by employer contributions and contributions from an employee's pre-tax income. Contributions and investment earnings grow tax deferred until withdrawal, when they are taxed as ordinary income.
- An **Individual(k)** is a defined contribution plan for businesses that employ only the owners, their spouses and partners. Individual(k) plans have very high contribution limits and allow participants to save for retirement quickly through salary deferrals and profit-sharing. The 2009/2010 contribution limits for individuals under the age of 50 is \$49,000 and for individuals age 50 or older is \$54,500. Contributions are deductible for federal income tax purposes and earnings grow tax deferred.

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When planning for the future, it is important to take advantage of every tool possible — after all, setting aside money today is the best way to help ensure that tomorrow's retirement is everything you want it to be.

Remember to consider the benefits of tax-advantaged accounts such as IRAs, 401(k)s, annuities and college-savings plans first. Then, take a look at the long-term investments that carry the lowest federal income tax burden on capital gains.

Here are just a few of the retirement-savings options that may be available to you.

- **Employer plan with a match** — If your employer offers matching contributions to your retirement plan, be sure to contribute the maximum the employer is willing to match. Even if your employer only makes a partial match, you should still take advantage of this opportunity. It is additional money that can compound and grow.
- **Employer plan without a match** — Even if your employer does not match your contributions to your company-sponsored retirement account, you should generally participate. Contributions and earnings within a qualified plan are not subject to federal income tax until withdrawn, which allows you to save money on a pre-tax basis.
- **Taxable investments** — When setting aside money for retirement, you should first contribute to plans that offer tax advantages, such as employer-sponsored plans and IRAs. Once you have reached the contribution limits on those plans, you should consider taxable investments. The key is keeping your expenses down by:
 - Taking advantage of lower federal income tax rates on long-term capital gains by holding stocks for more than 12 months.
 - Choosing mutual funds with a lower annual turnover.
- **Annuities** — An annuity is similar to a 401(k) or an IRA in that investment earnings are not taxable until withdrawn. However, with an annuity, there is no limit on how much you may contribute. Some investors use annuities to build tax-deferred earnings without intending to annuitize. Others buy annuities as personal pensions to provide a stream of guaranteed lifetime income.

12 OPTIONS FOR MILITARY SERVICEMEMBERS

Thrift Savings Plan (TSP)

Servicemembers have another retirement option. The government-sponsored Thrift Savings Plan (TSP) generally works like a 401(k) plan offered by some civilian employers. You may contribute any whole percentage of your basic pay, bonuses, incentives or special pays, before federal income taxes, up to an allowable maximum. The plan offers a variety of options.

Features Of A TSP

You can contribute to the TSP and to an IRA, although your IRA contribution may not be tax deductible based on IRS rules. You can borrow from your TSP account without penalty. Repayments and interest go back into your account.

You are subject to federal income taxes and penalties if you withdraw your money before you are age 59½. If, however, you separate from military service at age 55 or older, withdrawals from your TSP are not subject to IRS penalties.

When you leave military service you have several options with your TSP.

- Take the money in a lump sum.
- Select an annuity.
- Establish monthly payments.
- Leave the money in the TSP until you must withdraw at age 70½.
- Roll over the money into an IRA or other retirement account.

To learn more about the TSP, visit the Thrift Savings Plan Web site at www.tsp.gov.

Tax Relief For Military Families

A provision of the Heroes Earnings Assistance and Relief Tax Act of 2008, or HEART Act, includes tax-free savings options for individuals who receive military death gratuities or payments under the Servicemembers' Group Life Insurance (SGLI) program. The death payment can be rolled over, free of federal income tax, to a Roth IRA and/or Coverdell Education Savings Account. The full amount can be rolled over regardless of other income or contribution limits that may apply.

This allows military family members to realize the potential long-term benefits of tax-free earnings on investments.

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