Santa Barbara Independent WHO. WHAT. NOW.

Care and Feeding of IRA

Six Pitfalls to Avoid

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Dear Kevin,

I want to contribute to my IRA, but I'm always afraid I'm doing it wrong. What are the do's and don'ts?

Lorraine in Santa Maria

Dear Lorraine,

There are at least 6 mistakes to avoid when contributing to your IRA.

The first is making only one contribution at a time. After making last year's contribution, you should start working on this year's contribution right away.

If you can already come up with an extra $5,000 now, and fully contribute for 2008, great. That means you'll always be one year ahead. Over time, your final account balance could total thousands more due to the added time your money has spent in the market.

If making both last year's contribution and this year's contribution is not feasible, make last year's contribution, then start making monthly contributions toward 2008. At $416 per month, you'll get close to the $5,000 IRA contribution limit by year's end.

Getting your contribution in as early as possible allows your funds to increase in value.

The primary advantage of an IRA is not the current tax deduction; it's the tax-deferred growth of the traditional IRA, or the potential for tax-free growth of the Roth IRA. The sooner your money can go to work for you, the greater the odds your account balance will grow significantly.

Secondly, **don't forget to make that spousal contribution**. Even if only one spouse works outside the home, both spouses are eligible to make IRA contributions. Wouldn't it be nicer to have two IRA accounts to draw from when retirement comes along?

And you don't even have to have the same type of IRA. One might choose to use a Roth IRA, while the other chooses the traditional IRA. Depending on your income, though, neither of you may qualify to contribute to a Roth IRA; and if the working spouse participates in a retirement plan, the contribution to a traditional IRA may or may not be deductible. Find out your options and investigate the possibility of sheltering more money from taxes via a second IRA.

Another big mistake is missing your contribution deadline completely. It's common for taxpayers to think they have until their tax-filing deadline to make their IRA contributions. **It must be made by April 15, regardless of any tax filing extension**. But, SEP-IRAs, 401(k)s, and other retirement plans each work differently. SEP-IRAs for example, allow for contributions to be made at the same time as tax filing.

A fourth set of mistakes is making contributions when you're not allowed to, contributing too much, and erring with regard to rollover.

For example, after age 70.5, you are no longer allowed to make a contribution into a traditional IRA. Also, if you don't have any earnings, even if you receive income from rental property, you don't qualify to make an IRA contribution. If you earn too much money, you may not qualify either. In 2007, the Roth IRA allowed contributions for single taxpayers who earned up to $99,000. After they reached that level, their ability to contribute to an IRA phased out when they hit $114,000. For married taxpayers, the income phase-out occurs from between $156,000 and $166,000.

Beware of contributing too much as well. One person cannot contribute $5,000 to a Roth and $5,000 to a traditional IRA at the same time.

And stay clear of an ineligible rollover. An IRA holder is allowed to pull money from their IRA, and experience no tax consequences, if they re-deposit the funds within 60 days. But you can only do this once a year, and if you make a mistake there will be tax penalties.

Tracking your contribution is also integral to the process. Check your statements, because it's not unusual for institutions managing your IRAs to place the wrong amount in the wrong account. For example, if a $10,000 contribution meant for a SIMPLE IRA (a type of company sponsored retirement plan) ends up in a traditional IRA, it would result in a significant over-contribution and possible excise tax penalties.

People also seem to make mistakes when calculating their required minimum distribution (RMD) from the **wrong account balances**. If you turned 70.5 in 2007, you need to begin taking RMDs from the account balance of the correct year: 2006, *not* 2007. In future years, you will use the most recent year-end balances to calculate your RMD. If the RMD is handled improperly, the IRS imposes a 50% excise tax on the amount they failed to take. Pretty harsh. In fact, it is **the worst IRS penalty I'm aware of**. In every year except the first, they take from the most recent year-end balance. This is why it is done incorrectly so often

Lastly, it is critical to follow up on tax-refund direct deposits to your IRA accounts. **If the IRS places the refund in your account after April 15**, it your refund may be credited to your IRA contribution for the next year. In other words, your 2007 refund will be applied to 2008 and you'll miss out on the benefits of having more money in your account for a whole year.

IRAs are great saving devices, but they're often fraught with landmines. Stay informed, and continue to talk with your financial professional about making your money work best for you.

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