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IRAs

Prepared for:
Duane's Instructor Corner

Understanding IRAs

An individual retirement arrangement (IRA) is a personal savings plan that offers specific tax benefits. IRAs are one of the most powerful retirement savings tools available to you. Even if you're contributing to a 401(k) or other plan at work, you should also consider investing in an IRA.

What types of IRAs are available?

The two major types of IRAs are traditional IRAs and Roth IRAs. Both allow you to contribute as much as \$5,000 in 2010 and 2011. You must have at least as much taxable compensation as the amount of your IRA contribution. But if you are married filing jointly, your spouse can also contribute to an IRA, even if he or she does not have taxable compensation. The law also allows taxpayers age 50 and older to make additional "catch-up" contributions. These folks can contribute up to \$6,000 in 2010 and 2011.

Both traditional and Roth IRAs feature tax-sheltered growth of earnings. And both give you a wide range of investment choices. However, there are important differences between these two types of IRAs. You must understand these differences before you can choose the type of IRA that's best for you.

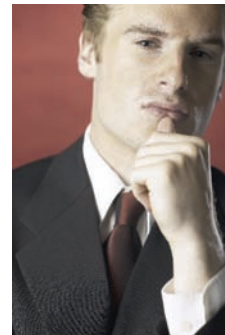
Note: *Special rules apply to qualified individuals impacted by certain natural disasters, and certain reservists and national guardsmen called to active duty after September 11, 2001.*



Learn the rules for traditional IRAs

Practically anyone can open and contribute to a traditional IRA. The only requirements are that you must have taxable compensation and be under age 70½. You can contribute the maximum allowed each year as long as your taxable compensation for the year is at least that amount. If your taxable compensation for the year is below the maximum contribution allowed, you can contribute only up to the amount that you earned.

Your contributions to a traditional IRA may be tax deductible on your federal income tax return. This is important because tax-deductible (pretax) contributions lower your taxable income for the year, saving you money in taxes. If neither you nor your spouse is covered by a 401(k) or other employer-sponsored plan, you can generally deduct the full amount of your annual contribution. If one of you is covered by such a plan, your ability to deduct your contributions depends on your annual income (modified adjusted gross income, or MAGI) and your income tax filing status.



For 2011, if you are covered by a retirement plan at work and:

- Your filing status is single or head of household, and your MAGI is \$56,000 or less, your traditional IRA contribution is fully deductible. Your deduction is reduced if your MAGI is more than \$56,000 and less than \$66,000, and you can't deduct your contribution at all if your MAGI is \$66,000 or more.
- Your filing status is married filing jointly or qualifying widow(er), and your MAGI is \$90,000 or less, your traditional IRA contribution is fully deductible. Your deduction is reduced if your MAGI is more than \$90,000 and less than \$110,000, and you can't deduct your contribution at all if your MAGI is \$110,000 or more.
- Your filing status is married filing separately, your traditional IRA deduction is reduced if your MAGI is less than \$10,000, and you can't deduct your contribution at all if your MAGI is \$10,000 or more.

For 2011, if you are not covered by a retirement plan at work, but your spouse is, and you file a joint tax return, your traditional IRA contribution is fully deductible if your MAGI is \$169,000 or less. Your deduction is reduced if your MAGI is more than \$169,000 and less than \$179,000, and you can't deduct your contribution at all if your MAGI is \$179,000 or more.

What happens when you start taking money from your traditional IRA? Any portion of a distribution that represents deductible contributions is subject to income tax because those contributions were not taxed when you made them. Any portion that represents investment earnings is also subject to income tax because those earnings were not previously taxed either. Only the portion that represents nondeductible, after-tax contributions (if any) is not subject to income tax. In addition to income tax, you may have to pay a 10 percent early withdrawal penalty if you're under age 59½, unless you meet one of the exceptions.



If you wish to defer taxes, you can leave your funds in the traditional IRA, but only until April 1 of the year following the year you reach age 70½. That's when you have to take your first required minimum distribution from the IRA. After that, you must take a distribution by the end of every calendar year until you die or your funds are exhausted. The annual distribution amounts are based on a standard life expectancy table. You can always withdraw more than you're required to in any year. However, if you withdraw less, you'll be hit with a 50 percent penalty on the difference between the required minimum and the amount you actually withdrew.

Learn the rules for Roth IRAs

Not everyone can set up a Roth IRA. Even if you can, you may not qualify to take full advantage of it. The first requirement is that you must have taxable compensation. If your taxable compensation in 2011 is at least \$5,000, you may be able to contribute the full amount. But it gets more complicated. Your ability to contribute to a Roth IRA in any year depends on your MAGI and your income tax filing status.

- If your filing status is single or head of household, and your MAGI for 2011 is \$107,000 or less, you can make a full contribution to your Roth IRA. Your Roth IRA contribution is reduced if your MAGI is more than \$107,000 and less than \$122,000, and you can't contribute to a Roth IRA at all if your MAGI is \$122,000 or more.
- If your filing status is married filing jointly or qualifying widow(er), and your MAGI for 2011 is \$169,000 or less, you can make a full contribution to your Roth IRA. Your Roth IRA contribution is reduced if your MAGI is more than \$169,000 and less than \$179,000, and you can't contribute to a Roth IRA at all if your MAGI is \$179,000 or more.

- If your filing status is married filing separately, your Roth IRA contribution is reduced if your MAGI is less than \$10,000, and you can't contribute to a Roth IRA at all if your MAGI is \$10,000 or more.

Your contributions to a Roth IRA are not tax deductible. You can invest only after-tax dollars in a Roth IRA. The good news is that if you meet certain conditions, your withdrawals from a Roth IRA will be completely income tax free, including both contributions and investment earnings. To be eligible for these qualifying distributions, you must meet a five-year holding period requirement. In addition, one of the following must apply:

- You have reached age 59½ by the time of the withdrawal
- The withdrawal is made because of disability
- The withdrawal is made to pay first-time home-buyer expenses (\$10,000 lifetime limit)
- The withdrawal is made by your beneficiary or estate after your death

Qualified distributions will also avoid the 10 percent early withdrawal penalty. This ability to withdraw your funds with no taxes or penalties is a key strength of the Roth IRA. And remember, even nonqualified distributions will be taxed (and possibly penalized) only on the investment earnings portion of the distribution, and then only to the extent that your distribution exceeds the total amount of all contributions that you have made.



Both traditional and Roth IRAs feature tax-sheltered growth of earnings. And both give you a wide range of investment choices. However, there are important differences between these two types of IRAs. You must understand these differences before you can choose the type of IRA that's best for you.

Another advantage of the Roth IRA is that there are no required distributions after age 70½ or at any time during your life. You can put off taking distributions until you really need the income. Or, you can leave the entire balance to your beneficiary without ever taking a single distribution. Also, as long as you have taxable compensation and qualify, you can keep contributing to a Roth IRA after age 70½.

Choose the right IRA for you

Assuming you qualify to use both, which type of IRA is best for you? Sometimes the choice is easy. The Roth IRA will probably be a more effective tool if you



don't qualify for tax-deductible contributions to a traditional IRA. However, if you can deduct your traditional IRA contributions, the choice is more difficult. Most professionals believe that a Roth IRA will still give you more bang for your dollars in the long run, but it depends on your personal goals and circumstances. The Roth IRA may very well make more sense if you want to

minimize taxes during retirement and preserve assets for your beneficiaries. But a traditional deductible IRA may be a better tool if you want to lower your yearly tax bill while you're still working (and probably in a higher tax bracket than you'll be in after you retire). A financial professional or tax advisor can help you pick the right type of IRA for you.

Note: You can have both a traditional IRA and a Roth IRA, but your total annual contribution to all of the IRAs that you own cannot be more than \$5,000 in 2011 (\$6,000 if you're age 50 or older).

Even if you're contributing to a 401(k) or other plan at work, you should also consider investing in an IRA. IRAs are one of the most powerful retirement savings tools available to you.

Know your options for transferring your funds

You can move funds from an IRA to the same type of IRA with a different institution (e.g., traditional to traditional, Roth to Roth). No taxes or penalty will be imposed if you arrange for the old IRA trustee to transfer your funds directly to the new IRA trustee. The other option is to have your funds distributed to you first and then roll them over to the new IRA trustee yourself. You'll still avoid taxes and penalty as long as you complete the rollover within 60 days from the date you receive the funds.

You may also be able to convert funds from a traditional IRA to a Roth IRA. This decision is complicated, however, so be sure to consult a tax advisor. He or she can help you weigh the benefits of shifting funds against the tax consequences and other drawbacks.

Note: The IRS has the authority to waive the 60-day rule for rollovers under certain limited circumstances, such as proven hardship.



Comparison of Traditional IRAs and Roth IRAs



	Traditional IRA	Roth IRA
Maximum yearly contribution (2011)	Lesser of \$5,000 or 100% of earned income (\$6,000 if age 50 or older)	Lesser of \$5,000 or 100% of earned income (\$6,000 if age 50 or older)
Income limitation for contributions	No	Yes
Tax-deductible contributions	Yes. Fully deductible if neither you nor your spouse is covered by a retirement plan. Otherwise, your deduction depends on your income and filing status.	No. Contributions to a Roth IRA are never tax deductible.
Age restriction on contributions	Yes. You cannot make annual contributions beginning with the year you reach age 70½.	No
Tax-deferred growth	Yes	Yes; tax free if you meet the requirements for a qualified distribution.
Required minimum distributions during lifetime	Yes. Distributions must begin by April 1 following the year you reach age 70½.	No. Distributions are not required during your lifetime.
Federal income tax on distributions	Yes, to the extent that a distribution represents deductible contributions and investment earnings.	No, for qualified distributions. For nonqualified distributions, only the earnings portion is taxable.
10% penalty on early distributions	Yes, the penalty applies to taxable distributions if you are under age 59½ and do not qualify for an exception.	No, for qualified distributions. For nonqualified distributions, the penalty may apply to the earnings portion. (Special rules apply to amounts converted from a traditional IRA to a Roth IRA.)
Includable in taxable estate of IRA owner at death	Yes	Yes
Beneficiaries pay income tax on distributions after IRA owner's death	Yes, to the extent that a distribution represents deductible contributions and investment earnings.	Generally no, as long as the account has been in existence for at least five years.

Roth IRA contribution limits for 2011

If your 2011 federal income tax filing status is:	Your Roth IRA contribution is reduced if your MAGI is:	You cannot contribute to a Roth IRA if your MAGI is:
Single or head of household	More than \$107,000 but less than \$122,000	\$122,000 or more
Married filing jointly or qualifying widow(er)	More than \$169,000 but less than \$179,000 (combined)	\$179,000 or more (combined)
Married filing separately	More than \$0 but less than \$10,000	\$10,000 or more

These income ranges (other than married filing separately) are indexed for inflation each year.

Traditional IRA deduction limits for 2011

If you are covered by an employer-sponsored retirement plan and your MAGI exceeds certain established thresholds, your deduction for your traditional IRA contribution is reduced or eliminated as follows:

If your 2011 federal income tax filing status is:	Your IRA deduction is reduced if your MAGI is between:	Your deduction is eliminated if your MAGI is:
Single or head of household	\$56,000 - \$66,000	\$66,000 or more
Married filing jointly or qualifying widow(er)*	\$90,000 - \$110,000 (combined)	\$110,000 or more (combined)
Married filing separately	\$0 - \$10,000	\$10,000 or more

* If you're not covered by an employer plan, but your spouse is, your deduction is limited if your MAGI is \$169,000 to \$179,000, and eliminated if your MAGI exceeds \$179,000.

These income ranges (other than married filing separately) are indexed for inflation each year.

Low and middle-income taxpayers may qualify for a tax credit

To claim the credit, you must be at least 18 years old and not a full-time student or a dependent on another taxpayer's return. The credit is in addition to any income tax deduction you might qualify for with respect to your IRA contribution. Here are the credit rates, based on 2011 MAGI limits:

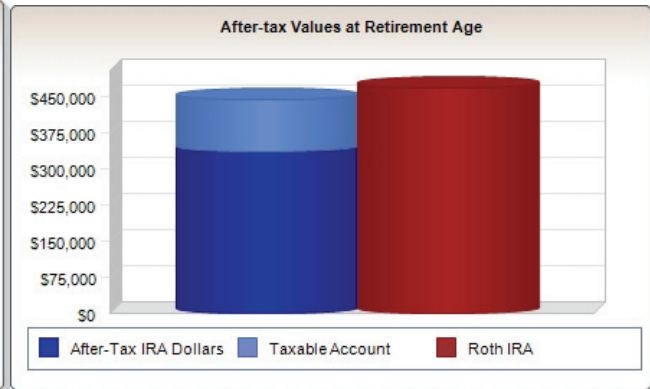
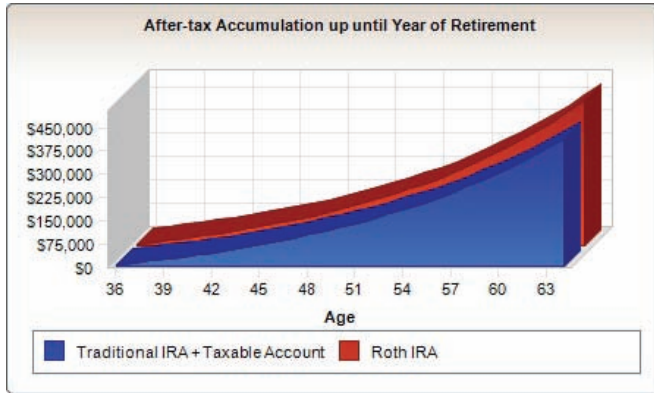
Joint Filers	Heads of Household	Single Filers	Credit Rate	Maximum Credit
\$0 - \$34,000	\$0 - \$25,500	\$0 - \$17,000	50% of contribution (up to \$2,000)	\$1,000
\$34,000 - \$36,500	\$25,500 - \$27,375	\$17,000 - \$18,250	20%	\$400
\$36,500 - \$56,500	\$27,375 - \$42,375	\$18,250 - \$28,250	10%	\$200
Over \$56,500	Over \$42,375	Over \$28,250	0%	\$0

Caution: The amount of any contribution eligible for the credit may be reduced by any taxable distributions you (or your spouse if you file a joint return) receive from an IRA or employer-sponsored retirement plan (or any nontaxable distributions from a Roth IRA) during the same tax year, during the period for filing your tax return for that year (including extensions), or during the prior two years.

IRA Future Value Illustration

These charts compare after-tax values for a Roth vs. a traditional IRA based on the assumptions that follow.

Current IRA balance:	\$0	Estimated annual rate of return:	7%
Annual contribution:	\$5,000	Estimated income tax before retirement:	35%
Years until retirement:	30 Years	Estimated income tax at retirement:	28%



Result at retirement: Value of Roth IRA: \$467,304. After-tax value of traditional IRA plus taxable account: \$442,380

Assumptions:

The same annual contribution is made at the end of each year until retirement. Earnings are compounded annually.

This illustration assumes that all traditional IRA contributions are fully tax deductible. However, note that if either the IRA owner or the IRA owner's spouse participates in an employer-sponsored retirement plan, the deductibility of contributions is subject to limitations based on tax filing status and modified adjusted gross income. This illustration assumes that an amount equal to the tax deduction each year is invested in a taxable account.

Withdrawals from traditional IRAs are subject to federal income tax to the extent that they consist of deductible contributions and investment earnings. Withdrawals made before age 59½ may also be subject to a 10 percent penalty.

Contributions to a Roth IRA are not tax deductible. Depending on an individual's tax filing status and modified adjusted gross income, allowable contributions to a Roth IRA may be limited.

Qualified distributions from a Roth IRA are not subject to federal income tax. Nonqualified withdrawals of earnings before age 59½ may be subject to income tax and a 10 percent penalty.

Note: This is a hypothetical example and is not intended to reflect the actual performance of any specific investment, nor is it an estimate or guarantee of future value. Investment fees and expenses, which are generally different for taxable and tax-deferred investments, have not been deducted. If they had been, the results would have been lower. The lower maximum tax rates on capital gains and qualified dividends would make the taxable investment more favorable than is shown in this chart. When making an investment decision, investors should consider their personal investment horizons and income tax brackets, both current and anticipated, as these may further impact the results of this comparison.



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