



Opening an IRA account is a must for New Jerseyans

Aaron Skloff's March IT'S YOUR BUSINESS column

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Q: My accountant said I can open an Individual Retirement Account (IRA), while my banker said I could not because of my income. What are the rules regarding IRAs and are there any unique considerations for New Jersey residents?

The problem: Qualifying for an IRA.

New Jersey's top state income tax rate is among the highest in the U.S. With a top rate of 9 percent, New Jersey ranks in the highest 10 percent of all states. Qualifying and utilizing an IRA could save a New Jersey resident thousands of dollars of unnecessary income taxes.

Contrary to popular belief, the qualifications for participating in an IRA are relatively modest.

The solution: An Individual Retirement Account.

Contributions to an IRA can be sheltered from taxation for as short as a day to as long as multiple generations. Outside of an IRA, investments that generate interest, dividends and gains are all subject to U.S. federal and New Jersey state taxes. Inside of an IRA, those same investments are sheltered from all taxes.

The power of tax sheltering.

To illustrate the benefits of tax sheltering let's utilize an example of two New Jersey residents. Harvey maximizes his IRA contribution of \$6,000 per year and earns 8 percent per year — leaving him with over \$274,000 at the end of 20 years. Marc invests the same amount, earns the same return, but does not utilize an IRA — leaving him with less than \$188,000 at the end of 20 years. By utilizing an IRA Harvey has accumulated an additional \$86,000, or 46 percent more wealth than Marc. Harvey is wealthier because he did not have to pay 35 percent U.S. federal taxes or 9 percent New Jersey state taxes.

Qualifying for an IRA.

Whether you earn over \$1 million per year or absolutely no income you can still qualify for an IRA. Even a child who earns income delivering newspapers can qualify for an IRA. In order to qualify for an IRA as a non-earner, your spouse must generate earned income. Earned income includes salary, self-employed income and sales commissions. It does not include interest, dividends, pension income or social security income.

Contribution Limits.

For 2008, contributions are limited to the lesser of earned income or \$5,000 for those under the age of 50 or \$6,000 for those aged 50 and over. For example, a 65 year-old retired husband and 63 year-old semi-retired wife, who earns \$12,000, could each contribute \$6,000 to an IRA in 2008. As another example, a 12 year-old part-time newspaper deliverer, who earns \$3,000, could only contribute \$3,000.

Traditional IRAs.

Contributions are fully tax deductible if you are not an active participant in an employer-sponsored retirement plan. Otherwise, the deduction begins to phase-out once your modified adjusted gross income (MAGI) exceeds \$53,000 for single filers or \$85,000 if both persons are covered and married filing jointly. With or without a deduction, earnings in a traditional IRA are sheltered from taxes until they are withdrawn.

Roth IRAs.

Contributions are never deductible and eligibility begins to phase-out once your MAGI exceeds \$101,000 for single filers or \$159,000 for those married filing jointly. The Roth IRA has a very important distinction from the traditional IRA. Not only is income sheltered from taxation while in the Roth IRA, but withdrawals are tax free. A traditional IRA is like "having your cake," while a Roth IRA is like "having your cake and eating it too."

Action steps: Start your IRA.

Question not, "Should I start an IRA?" instead question, "Which IRA should I do?" With such liberal restrictions, most people qualify for an IRA. The government realizes Social Security and Medicare are broken, while the costs in retirement are ballooning. Thus, it has essentially given taxpayers a gift in the form of an IRA. Do not look a gift horse in the mouth.

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