PERSONAL FINANCE INSIGHTS

Retirement contribution limits for the new year

The arrival of a new year has also brought some changes that impact contribution eligibility and limits to different types of retirement accounts. This month we review the latest provisions.

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Employer-sponsored accounts

The amount that you may contribute to an employer-sponsored retirement account has increased slightly for 2012. For 401(k), 403(b), and 457 plans, offered by corporate, nonprofit, and government employers, respectively, the maximum you may contribute via payroll deduction to such plans has increased by $500 to $17,000 annually. The increase is due to the cost-of-living index, which met the statutory threshold that allows for an adjustment in the maximum contribution level. This is the first increase since 2009.

If you will be 50 years of age or older by Dec. 31, 2012, you may contribute an additional $5,500 in 2012 (also known as the "catch-up" provision), though this amount is unchanged from last year. Consequently, if you will be at least 50 years of age during 2012, you may contribute a total of $22,500 to an employer-sponsored retirement account. Contributions to your employer-sponsored retirement account, when made on a pretax basis, have the benefit of lowering your taxable income (and thus your taxes), as well as assisting in saving for your retirement.

For those with SIMPLE IRAs, the maximum annual contribution remains unchanged at $11,500, as does the "catch-up" provision of an additional $2,500 for those individuals over 50.

IRA accounts

Unfortunately, the contribution limit also did not increase for Traditional and Roth IRAs for 2012. For such IRAs, you may contribute a total of $5,000 as your 2012 tax year contribution up until April 15, 2013. If you will be at least 50 years old at any time during 2012, you may contribute an additional $1,000. To qualify to make an IRA contribution, your taxable compensation must be equal to or greater than the contribution you wish to make.

To contribute to a Roth IRA, however, you must be income eligible. To make the full contribution to which you are otherwise entitled, your modified adjusted gross income (MAGI) during 2012 must be $110,000 or less as a single filer and $173,000 or less as a married individual, filing jointly. If your MAGI is between $110,000 and $125,000 as a single filer, or between $173,000 and $183,000 as a married individual, filing jointly, you are entitled to make a prorata contribution to a Roth and a Traditional IRA as long as your total contribution does not exceed the applicable limit.

If your MAGI exceeds the upper end of the applicable MAGI range, then you may contribute up to the allowed maximum to a Traditional IRA. You must be less than 70 1/2 years old to contribute to a Traditional IRA.

Under current law, if you do not qualify to contribute directly to a Roth IRA because your MAGI exceeds the allowed limits, you may contribute to a Traditional IRA and then convert the contribution (and other retirement assets, if you desire) to a Roth IRA, subject to limitations and possible taxes, which are beyond the scope of this article.

Other differences between IRAs

A couple of other differences between Roth and Traditional IRAs are worth noting. First, contributions to a Roth IRA cannot be used as a deduction to reduce the income taxes you pay, while contributions to a Traditional IRA may or may not be used as a deduction. Whether or not a Traditional IRA contribution can be deducted is dependent on your income level and whether you or your spouse participate in an employer-sponsored retirement plan.

Second, as long as distributions from a Roth IRA are considered "qualified," they are not subject to taxation, whereas distributions from a Traditional IRA are subject to taxation (except for the amount you contributed on an after-tax [nondeductible] basis). For a Roth, a "qualified" distribution is one made after a five-tax-year period has passed since the first contribution and one of the following apply: (1) the taxpayer has reached at least 59 1/2 years of age, (2) the IRA account owner has died or is disabled, or (3) to purchase a home, subject to restrictions.

If you have not yet retired and have sufficient cash flow, consider increasing your retirement contributions in order to be better prepared financially for your retirement. You may also reduce the taxes you would otherwise pay.

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