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Saving the Roth Way Hits the Spot

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Having trouble saving for long-term goals but don't quite know where to start? Have some great savings goals but fear you might need your money in an emergency? Roth IRAs can help.

Roth IRAs are designed to help people save for retirement. The essential features of Roth IRAs are: (1) they enable the accumulation of up to $2,000 per year in nondeductible contributions from earned income, and (2) they enable tax-free earnings on those contributions. Ordinarily, tax-free withdrawals of contributions and earnings may begin after five years and age 59½.

However, Roth IRAs also allow for tax-free and penalty-free withdrawals in other circumstances. For example, persons of any age can withdraw up to $10,000 tax-free and penalty-free after a five-year holding period if the money is used for a first-time home purchase. Couples can double the amount made available for a home purchase.

Many young couples do not put money into long-term savings because they fear they will not be able to get their money in an emergency. The Roth IRA allows penalty-free withdrawals of nondeductible contributions at any time. In other words, as long as the amount withdrawn does not exceed the amount contributed, the withdrawal is penalty-free. The amount is also tax-free because Roth IRA contributions, being nondeductible, have already been taxed.

Thus, in a sense, although Roth IRAs were not designed as special purpose or rainy-day savings funds, they can be used that way. A person that is contributing money to a company pension plan or deductible 401(k) or 403(b) might look upon the Roth IRA as a supplementary savings and retirement fund offering some very distinct advantages over other savings plans:

- Contributions may be withdrawn at any time without tax or penalty as long as the type of investments you have chosen allow for your withdrawal. In other words, a person could accumulate accessible contributions for any purpose and still build tax-free earnings.
- Contributions and earnings of up to $10,000 could be accumulated and withdrawn after five years without tax or penalty if used for a first-time home purchase.
- Contributions and earnings of any amount could be accumulated and withdrawn after five years and age 59½, or at any age if you become disabled.
- All contributions and earnings may be kept on account and actively invested even after age 70½—the age when most retirement plans are subject to required withdrawals.
- Contributions may still be made and earn tax-free interest after age 70½—the age when most retirement plans can no longer accept contributions.

Some younger people may not realize the value of being able to keep retirement funds working and even add to them after age 70½. But older people who may have meager retirement savings to begin with realize the risks in living beyond their means. These people often need and want the security of hanging on to their retirement funds as long as possible in order to ensure that they won't run out of money before they die. The Roth IRA allows older people to hang on to their savings as long as they feel it is necessary.

Although contributions can be made to a Roth IRA after age 70½, it should be remembered that the money must come from earned income. This includes wages, salary, tips, professional fees, and commissions. It does not include interest, dividends, rent, or retirement benefits. But those who still labor, counsel, write, create, and sell after age 70½ can contribute to their Roth IRAs.

If you already have a tax-deductible retirement plan and three months salary in easily accessible savings, you might consider starting a Roth IRA as an attractive, long-term savings option. This option will let you accumulate tax-free earnings while keeping your contributions close at hand.

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