The Basics of Roth IRA Contribution Rules

By Barbara E. Weltman AAA |

If you are working, you may be able to contribute to a Roth IRA. This type of retirement savings account allows you to take tax-free withdrawals of your contributions at any time and tax-free withdrawals of earnings on contributions after a five-year holding period (assuming you are at least 59½, disabled or using them for first-time home-buying expenses). Here are the rules to know about Roth IRA contributions.

Eligibility

The only requirement for contributing to a Roth IRA is having earned income. This is income from a job (including commissions, tips and taxable fringe benefits) or net earnings from self-employment (i.e., profits). Some types of income are treated as earned income for purposes of Roth IRA contributions: nontaxable combat pay, military differential pay and taxable alimony. A spouse who works can contribute to a Roth IRA for a nonworking spouse (assuming sufficient income).

However, your contribution may be limited or barred if your income is too high. Roth IRA contributions are phased out when modified adjusted gross income (MAGI) (essentially adjusted gross income without regard to the foreign earned income exclusion) exceeds a set limit for your tax filing status. Here are the limits for 2015 (they may be adjusted in the future to account for inflation):

- If you're married and file jointly or are a qualifying widow(er): full contribution if MAGI is no more than \$183,000; partial contribution for MAGI between \$183,000 and \$193,000; no contribution if MAGI is \$193,000 or more.
- If you're single, head of household, or married filing separately and you did not live with your spouse at any time during the year: full contribution if MAGI is no more than \$116,000; partial contribution for MAGI between \$116,000 and \$131,000; no contribution if MAGI is \$131,000 or more.
- If you're married filing separately but lived with your spouse at any time during the year: a partial contribution for MAGI between zero and \$10,000; no contribution if MAGI is \$10,000 or more.

There is no age threshold or limit for making Roth IRA contributions. For example, a teenager with a summer job can use the funds for a Roth IRA contribution. Also, someone working after the age of 70½ can continue to make Roth IRA contributions (in contrast to a traditional IRA, which bars contributions after age 70½).

Also, the fact that you participate in a qualified retirement plan has no bearing on eligibility to make Roth IRA contributions. So, if you have the money, you can contribute to a 401(k) plan at work and then contribute to your own Roth IRA.

Contribution limits

The maximum contribution for 2015 is \$5,500 (or \$6,500 if you're 50 or older by the end of the year). This dollar limit on annual contributions applies to total IRA contributions (including deemed traditional IRA and Roth IRA set up by an employer as a separate account under a qualified retirement plan). Thus, if you are 45 years old and contribute \$3,000 to a traditional IRA, the maximum contribution to a Roth IRA in 2015 is \$2,500 (\$5,500 – \$3,000 traditional IRA contribution).

An annual contribution cannot exceed earned income (and amounts treated as earned income listed above). For example, someone with wages of \$4,800 for the year can contribute up to \$4,800, regardless of age.

Conversions to a Roth IRA from a taxable retirement account, such as a 401(k) plan or a traditional IRA, have no impact on the contribution limit. However, making a conversion adds to MAGI, and may trigger or increase a phaseout of your Roth IRA contribution amount. Also, rollovers from one Roth IRA to another are not taken into account for purposes of making annual contributions.

Similarly, repayment of reservist distributions does not limit Roth IRA contributions. Reservist distributions are amounts withdrawn by a member of the Reserves called to active duty after September 11, 2001; these amounts may be recontributed within two years after the period of active duty ends.

Timing for Contributions

Contributions to a Roth IRA can be made up to the due date of the return for the year to which contributions relate. Thus, contributions to a Roth IRA for 2015 can be made through April 18, 2016 (or April 19 for those in Maine and Massachusetts), which is the due date for the 2015 income tax return. Obtaining an extension of time to file a tax return does not give you more time to make an annual contribution.

You can make a Roth IRA contribution by directing the IRS to apply some or all of a tax refund for this purpose. To use a 2015 refund to make a 2015 contribution, you must file early enough to ensure that the refund is applied before the April deadline. And you must instruct your Roth IRA trustee or custodian that you want the refund applied for 2015. You can also use a 2015 refund for a 2016 contribution (instruct the Roth IRA trustee or custodian accordingly).

Tax Break for Contributions

Contributions to Roth IRAs are not tax deductible. They are made with your after-tax earnings. The incentive for contributing to a Roth IRA is to create tax-free income for the future – not to obtain a current tax deduction.

However, you may be eligible for a tax credit for having made a contribution. The retirement savings credit is up to \$1,000, depending on your filing status, MAGI and Roth IRA contribution. For example, if you're a head of household with MAGI in 2015 of no more than \$27,375, contributing \$2,000 or more to a Roth IRA generates a \$1,000 tax credit.

Recordkeeping for Contributions

You do not have to report your Roth IRA contribution on your federal income tax return. However, it is highly advisable for you to keep track of it. This will help you demonstrate that you've met the five-year holding period for taking tax-free distributions of earnings from the account.

Each year that you make a Roth IRA contribution, the custodian or trustee will send you Form 5498, IRA Contributions. Box 10 of this form lists your Roth IRA contribution; keep the form with your tax returns records for each year that you make a Roth IRA contribution.

The Bottom Line

While not tax deductible, a Roth IRA gives you the opportunity to create a tax-free savings account that you can use in retirement or leave as an inheritance for your heirs. Whether a Roth IRA makes financial and tax sense for you depends on your situation. Discuss this with your tax advisor.

Saving for Retirement?

Retirement planning is a journey and it all starts with a good strategy. Whether you're just starting to save, building your wealth or living in retirement, E*TRADE offers a wide range of products and tools for every situation and life stage. Take the next step now and let E*TRADE help you reach your goals.