What is an IRA?

IRA is an Individual Retirement Account. An IRA is a private account used to defer taxes on funds you contribute to invest for retirement. Eligibility restrictions for IRAs are based on your income and employment status. The amount of money you can put into an IRA each year is limited and penalties will apply for early withdrawal. Taxes are due when funds are withdrawn in retirement. You can set up an IRA at a bank, federally insured credit union or IRS approved investment firm.

Contributions

Contributions to an IRA are determined by whether you earn taxable income and you're under the age of 70 ½. You're allowed an annual maximum contribution of $5,500 or $6,500 for anyone age 50 or older. A nonworking spouse of a wage earner filing a joint return can also contribute to an IRA. After you reach the age of 70 ½ you are not allowed to make contributions to certain types of IRAs. For any given tax year the contribution deadline is April 15 of the following year.

Deductions

Deductions will depend on whether the IRA is deductible or nondeductible. A deductible IRA allows you to deduct contributions on your tax return giving you a refund on taxes paid earlier in the year. Nondeductible IRAs are funded with after-tax dollars and those contributions cannot be deducted on your tax return. A deductible IRA is more desirable, but qualifying for a one depends heavily on amount of income, whether you are receiving Social Security benefits, if you have an employee-sponsored retirement plan and filing status.

Distributions

The year after you've reached age 70 ½ you have to start making withdrawals called minimum required distributions. The distribution amount depends on the sum of the account and your life expectancy according to tables published by the Internal Revenue Service. Roth IRAs have no age withdrawal mandate.

Penalties

Withdrawing money before age 59 ½ requires you to pay a 10 percent penalty as well as income tax on the full amount withdrawn. Some state taxes may also apply to contribution withdrawals. Qualified distributions from an IRA include but are not limited to, first-time home purchase (up to $10,000), college expenses, sudden disability or adjusted gross income exceeded by 7.5 percent for certain medical expenses. These qualified distributions are penalty-free as found in the IRS Publication 590.

Beneficiaries

A beneficiary is any person that the owner chooses to receive the IRA in the event of his death. As the sole beneficiary of your spouse's IRA you have several options: assume the IRA by leaving it where it is and treating it as your own; treat yourself as the beneficiary and withdraw from the IRA over a fixed period of time; or roll the IRA over into a new or existing account in your name. The beneficiary must include the taxable distributions received in gross income. If an IRA is inherited from someone other than your spouse you cannot treat it as your own or make any contributions to the IRA.