

# UNDERSTANDING IRAs

A Summary of Individual Retirement Accounts (IRAs)



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# Get Ready for Retirement

Financial experts estimate that you will need 70% to 90% of preretirement earnings to live comfortably during your retirement.<sup>1</sup> An Individual Retirement Account (IRA) is typically for someone who does not have access to an employer-sponsored plan and can be a good way to save toward meeting your retirement goals.

Although, if you participate in an employer-sponsored plan, it might not be enough to accumulate the savings you need. In either situation, an IRA can be a nice addition to complement your retirement needs.

## What Is an IRA?

An IRA is a personal retirement plan with tax benefits that allows your savings to grow, or compound, more quickly than in a taxable investment account.

You can choose from different types of vehicles to fund an IRA—including mutual funds, fixed annuities, fixed indexed annuities, registered index-linked annuities, and variable annuities.

### An IRA can help you:

- Save for retirement if you do not have access to an employer-sponsored retirement plan.
- Supplement your current savings in your employer-sponsored retirement plan.
- Take advantage of the power of compounding growth and allow your money to accumulate without paying taxes until withdrawn.



<sup>1</sup>Source: Employee Benefits Security Administration, United States Department of Labor. "Top 10 Ways to Prepare for Retirement," September 2023.

# Types of IRAs

There are several types of IRAs, but the most common and the focus of this brochure are the traditional IRA and the Roth IRA.

## Traditional IRA

With a traditional IRA, taxpayers and their spouses with earned income no longer have age limits to contribute to the account. Depending on your income level, a traditional IRA offers a tax deduction for all or part of your contributions. If you do not have access to an employer-sponsored retirement plan, you can contribute up to the annual limits, as long as you don't exceed your earned income. If you do have access to an employer-sponsored retirement plan, your IRA contributions may still be tax-deductible, depending on your tax-filing status and modified adjusted gross income.

If you need to withdraw money from a traditional IRA before you reach age 59½, you will have to pay income tax and an additional 10% federal income tax. However, there are some exceptions to this additional 10% federal income tax for withdrawals, such as first-time home purchase, death, disability, or certain qualifying medical expenses.

## Roth IRA

A Roth IRA allows you to make contributions with after-tax money without current income-tax deductions. You pay taxes now and may enjoy tax-free income later, provided you hold the Roth IRA for at least five years and don't take distributions before reaching age 59½.

If you do not meet the five years and attaining age 59½ requirements and need to take a distribution, you may owe income tax on earnings, and an additional 10% federal income tax may apply to the earnings and prior converted amounts. Similar to the traditional IRA, there are exceptions to this additional 10% federal income tax for withdrawals and the 59½ age requirement, such as first-time home purchase, death, disability, certain qualifying medical expenses, health insurance premiums, or higher-education expenses.

## Contribution Limits

The maximum amount you may contribute to your traditional IRA and Roth IRA depends on your earned income and the maximum annual contribution limit (listed below). Your annual contribution may not exceed your earned income.

| Maximum Annual Contribution Limit<br>for Traditional and Roth IRAs | 2025    | 2026    |
|--------------------------------------------------------------------|---------|---------|
|                                                                    | \$7,000 | \$7,500 |

Additionally, when you reach age 50 (or older), you can make extra “catch-up” contributions of \$1,000 in 2025 and \$1,100 in 2026.

Although the annual contribution limit applies to the calendar year (January through December), you actually have until your tax filing due date (usually April 15), not including extensions, to make your contribution. Please talk to your financial professional regarding tax-deductible limits.



## What Are the Differences?

|                                              | Traditional IRA                                                                                                                                                                                                                       | Roth IRA                                                                                                                                                                                                                                                                                                                                                                                                |
|----------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Contribution Requirements</b>             | <ul style="list-style-type: none"> <li>• Must have earned income.</li> <li>▪ No age restrictions.</li> <li>▪ Individuals with certain modified adjusted gross income levels may not be able to fully deduct contributions.</li> </ul> | <ul style="list-style-type: none"> <li>▪ Must have earned income.</li> <li>▪ No age restrictions.</li> <li>▪ Individuals with certain modified adjusted gross income levels may not be able to make contributions.</li> </ul>                                                                                                                                                                           |
| <b>Taxation of Distributions</b>             | <ul style="list-style-type: none"> <li>▪ Taxed as ordinary income.</li> </ul>                                                                                                                                                         | <ul style="list-style-type: none"> <li>▪ Qualified distributions are tax-free.</li> <li>▪ A qualified distribution is any distribution that meets the five-year holding requirements and is taken after meeting one of the following reasons: <ul style="list-style-type: none"> <li>• Attain age 59½</li> <li>• First-time home purchase</li> <li>• Disability</li> <li>• Death</li> </ul> </li> </ul> |
| <b>Distributions before Age 59½</b>          | <ul style="list-style-type: none"> <li>▪ Taxable distributions may be subject to an additional 10% federal income tax.</li> </ul>                                                                                                     | <ul style="list-style-type: none"> <li>▪ Distributed earnings may be taxable and subject to an additional 10% federal income tax.</li> <li>▪ Distributed conversion amounts, if taken within five years of conversion, may be subject to an additional 10% federal income tax.</li> <li>▪ Contributions are not subject to any federal taxes or an additional 10% federal income tax.</li> </ul>        |
| <b>Required Minimum Distributions (RMDs)</b> | <ul style="list-style-type: none"> <li>▪ RMDs must be taken each year beginning at age 73.</li> <li>▪ First RMD can be delayed until April 1 of the next year after attaining age 73.</li> </ul>                                      | <ul style="list-style-type: none"> <li>▪ Not applicable for owners.</li> </ul>                                                                                                                                                                                                                                                                                                                          |
| <b>Distributions to Beneficiaries</b>        | <p>In general, the distributions must be paid within 10 years; however, certain beneficiaries may be able to spread the distributions over their life expectancies. A spousal beneficiary may roll to his or her own IRA.</p>         |                                                                                                                                                                                                                                                                                                                                                                                                         |

# Important IRA Information

## Converting a Traditional IRA to a Roth IRA

The tax-free distribution from a Roth IRA may be beneficial to your situation, and you may want to consider converting your traditional IRA to a Roth IRA. There is no 10% federal income tax when you convert a traditional IRA to a Roth IRA. While you will owe income tax on the amount converted, future earnings in the Roth IRA will accumulate tax-deferred and may be distributed tax-free—as long as certain requirements are met.

If you convert your traditional IRA to a Roth IRA and withdraw money before you reach age 59½, you may have to pay income tax (on earnings distributed) and possibly an additional 10% federal income tax (on earnings distributed and the conversion amount if distributed within five years from conversion). Due to the Tax Cuts and Jobs Act, after 2017, once one elects a Roth conversion, it can no longer be recharacterized (that is, “undo the conversion”) back to a traditional IRA.

## Funding

Because you can fund your IRA with a variety of investments, such as mutual funds or annuities, it's important to understand that under current law, a nonqualified annuity that is owned by an individual is generally entitled to tax deferral. IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax-deferred. Therefore, an annuity should be used only to fund an IRA or qualified plan to benefit from the annuity's features other than tax deferral. These include lifetime income, death benefits, and the ability to transfer among investment options without sales or withdrawal charges.

## Flexibility

IRAs allow you to transfer among financial institutions. If you move your IRA without making a withdrawal (called a direct transfer), you will not face any tax consequences.

If you take a withdrawal from your IRA in cash or by check before transferring it (called an indirect rollover), the IRA custodian must withhold 10% of your distribution for federal taxes unless you elect otherwise. After you withdraw the money, you must roll over the full amount of the withdrawal, including any money that was withheld for taxes, into a new IRA account within 60 days, or pay income tax and possibly an additional 10% federal income tax on the amount not returned to an IRA.

If you roll assets from one IRA to another IRA, it is important to remember that only one indirect rollover among all of your IRAs per 12-month period is permitted. This rule does not apply to rollovers from qualified plans to IRAs or a direct transfer between IRAs.



To learn more about traditional and Roth IRAs,  
speak with your financial professional or visit our website.

[PacificLife.com](http://PacificLife.com)

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