Taxes

IRA Is No Magic Bullet

Lauren Keyson 02.20.07, 3:30 PM ET

It's that time of year again--tax preparation anxiety time--and individual retirement accounts come to mind as you scramble to find ways to maximize your savings. You can play it safe and hands-off by opening an IRA at a bank and buying a CD. Or, you can manage your own risk by opening an IRA with a broker and mixing it up with stocks, bonds and mutual funds. You can even go to a wholesale lender focused on non-recourse mortgages and fill it with real estate.

Many people look to an IRA as a quick-fix solution to save on taxes and don't think about it in a longer time frame. You can lose money if you open an IRA that is just a statement savings account with a low rate of return; it may not keep up with inflation.

"Just because I've opened an IRA does not ensure my financial success if I have no plan," says W. Rod Gentry, senior vice president of Union Bank & Trust. "Everybody's situation is different, and I think people need to develop financial goals for retirement, for the present, for anytime--and then develop a plan to achieve those goals over time."

Retirement and the future of Social Security are people's biggest financial concerns today--yet 52% of Americans don't even have an IRA, according to the 2007 American Retirement Study put out by Scottrade this week. "According to the study, there is a big gap in what people should be doing, and what they are doing," says Chris Moloney, chief marketing officer at Scottrade. "Although people are concerned about retirement, very few are really taking as much action on IRAs as they should."

When considering your overall financial picture, don't look at an IRA as if you are "buying" a single product. Instead, realize that you are opening an account that you can fill up with many different products and assets, including mutual funds, stocks, bonds, exchange-traded funds and even real estate--any assets that the IRS will let you invest in. Not knowing what you can buy for your IRA can hurt your financial future.

"I think that the younger generation is allocating more of their assets into pure equities," says Will Retzer, analyst at SNL Financial.

The good news is that there are thousands of investments allowed in an IRA. "There are only two assets you are not allowed to buy inside your individual retirement plan: insurance and collectibles," says Jay Michalowski, president and founder of First IRA, a financial services and IRA mortgage lender. "You can't buy wine or a '66 Chevy in your IRA."

When it comes to IRAs, it's important to place your money in something that will match your overall financial picture. "It makes little sense for 25-year-olds to place all of their IRA money into CDs earning 5%, which is too conservative," says John-Patrick O'Sullivan of SNL Financial. "They will barely be outpacing inflation, which is a threat to financial success for young people's savings. Just as it's probably not the best strategy for a 59-year-old to place all of their IRA money into emerging-market funds, which can be too aggressive for them."

Not surprisingly, many individual investors don't even know about the nontraditional investments allowed in an IRA. For instance, individuals have had the opportunity to invest funds inside their IRAs into real estate since 1974. "But Wall Street hasn't let them do this," says Michalowski. "Wall Street has really pushed everyone into buying stocks and mutual funds for ease of management."

While the concept of investing in real estate within your IRA is still relatively unknown, that's all changing as investors become frustrated with the volatility of the stock market, worry about risk and look for alternative investments.

It's hard to believe that something that provides tax and forced retirement savings has negatives, but like any investment, the cons exist. IRAs can reduce liquidity. If not planned out, they can lose money against inflation. And if the stock market crashes and you sell the stocks you have in your IRA, you can't deduct the losses on your income tax return.

"But let's say that I bought some stock with my own after-tax money, and I lost the money--I can write that off on my tax return," says Stephen Shonka, a financial adviser with MassMutual Financial Group. "You don't want to be too aggressive or too speculative with IRA money, because you can't deduct loses. You want to be more aggressive or speculative with something that at least you can then use to offset your income if you're wrong."

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