How to Get the Most Out of Your IRA Contributions

Tips for selecting the right account type, using new contributions to adjust your portfolio's allocations.
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The goal of my 2017 financial to-do list is to break down the broader goal of improving financial fitness into smaller, more manageable pieces.

On the docket for March: contributing to an IRA or health savings account for the 2016 tax year. Of course, in an ideal world you wouldn't wait until the last minute--your tax-filing deadline, which is April 18 this year--to contribute to these accounts for the year prior. As discussed here, these 11th-hour contributions can cost you some compounding.

But let's face it, many investors *do* wait until the following year to make their IRA contributions, and it's better later than never. If you're just getting around to contributing to an IRA for the 2016 tax year, here are some tips for getting the most from your contribution.

Identify the Right Type
One of the first decisions you'll need to make when contributing to an IRA is whether to steer those dollars into a traditional IRA or a Roth account. Of course, income limits may rule out a traditional deductible IRA right out of the box; to make a traditional IRA contribution and deduct it on your tax return, your adjusted gross income needs to be less than $72,000 if you're a single filer and $119,000 if you're part of a married couple filing jointly, assuming you can contribute to a retirement plan at work. Meanwhile, income limits are more generous for Roth contributions, and even investors with very high incomes can get into a Roth via the "backdoor" as discussed in this article. (This article provides the specifics on IRA income limits for 2017.)

If your income puts both account types within reach, the key question to ask is if you're better off taking the tax break now, at the time of your contribution, or waiting until you're retired to take it. (The same calculus comes into play if you can steer your 401(k) contributions to either a Roth account or a traditional one.) If the answer is "now" because you think you're in a high tax bracket relative to where you're apt to be in retirement, you're a good candidate for a traditional deductible IRA, assuming your income allows you to contribute to such an account. (That's not often the case for investors in this situation, as their taxable income is high so they cannot deduct their contributions.) If the answer is that you're more likely to need the tax break in retirement, or that your current tax rate is quite low relative to what it's apt to be in the future (for example, you're a bright shiny new graduate who's not making much currently), a Roth IRA is the better bet. It's also possible to split your contributions across both account types in a single year.

Don't Forget about the Nonearning Spouse
Single-earner couples can fall behind on the retirement-savings front, which is why it's so important for them to fund an IRA on behalf of the spouse who's not generating an income currently. You won't find an account called a "spousal IRA" on your brokerage firm or fund company's website, but you can fund the IRA of your choice in the nonearning spouse's name. The one caveat is that the earning spouse must enough earned income to cover the contribution(s).

Use New Contributions to Address Portfolio Problem Spots
After selecting your IRA type and getting the IRA account funded, the next step is deciding what type of investment to put that money into. Many investors stall out on this step, according to Vanguard research, likely paralyzed by their (too?) many investment choices. My advice is to start by using Morningstar X-Ray to view your portfolio's asset allocation and sub-allocations; you can then identify areas where your portfolio is light, such as bonds or international stocks. (The weightings in Morningstar's Lifetime Allocation Indexes--or those of a good target-date fund, such as the Vanguard or Blackrock series--provide some benchmarks for sensible asset

allocations.) Of course, if you have a larger portfolio and its allocations are seriously out of whack, new IRA contributions won't be enough to move the needle; you'll need to engage in rebalancing.

Take Time to Conduct 'IRA Maintenance'

For many investors, their IRAs play second fiddle to their company retirement plans, which allow for higher annual contributions. It can be easy to lose track of what investments you hold in your IRA accounts, or to think of them as unimportant supporting players in your overall plan. Thus, if you haven't taken a close look at what's in your IRA for awhile, or if you have several smaller IRAs, it's valuable to use IRA-contribution season as an impetus to check up on how these accounts fit into the whole of your portfolio. It's also a good time to check up on the status of your accounts: For example, if you've been getting into a Roth IRA via the backdoor, make sure that you're periodically converting those traditional IRA accounts to Roth.