

# IRA Contribution Deadline: Avoid Penalties & Optimize Your Retirement Savings

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*Don't miss the April 15, 2025 deadline for 2024 IRA contributions. Learn how to avoid penalties, understand income limitations, and leverage the 5-year Roth rule.*

## By Nick Defenthaler

As we quickly approach the 2024 tax filing deadline of April 15, 2025, many folks are scrambling to not only complete their taxes, but also explore funding traditional IRAs or Roth IRAs for 2024. Because traditional IRAs and Roth IRAs carry income limitations on either contribution amounts or level of tax deductibility, the IRS kindly allows Americans to contribute to these retirement vehicles by the tax filing deadline of the previous year, e.g., you have until April 15, 2025 to make a 2024 traditional or Roth IRA contribution.

For 2024 (and tax year 2025), the maximum contribution amount to each account is \$7,000 (\$8,000 if over the age of 50). If you have excess cash to save towards retirement right now, or if you're unsure of how your employer retirement plan (401(k), 403(b), etc.) should be allocated (pre-tax vs. Roth contributions), now is a good time to chat with your adviser. As with most financial strategies, this decision involves several factors that we'll dive into.

## Tax Considerations

Generally speaking, if you expect to be in a higher tax bracket in the future when you plan on drawing funds from your retirement account, as compared to the bracket you're currently in, Roth contributions (Roth IRA or Roth 401(k)) are likely your best bet. However, if you expect to be in a lower tax bracket in the future when funds are drawn from your accounts, as compared to your current tax bracket, making traditional (pre-tax) IRA or 401(k) contributions will likely be advisable. The visual below does a great job illustrating this:

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The problem with this decision is that no one has the proverbial crystal ball to know exactly what tax bracket they will fall into in the future. Income spikes in certain years or the ever changing tax landscape could throw a wrench into any well thought out plan that at the time made perfect sense with the facts available. Just like we want to diversify the investments within a portfolio, diversifying the tax treatment of accounts is also advised in many cases as this can help to mitigate the risk of future tax uncertainty.

### **Time Horizon Considerations**

Regardless of the type of account you're looking at investing your hard-earned money into, an important question you should ask yourself is "when might I actually need the funds I'm looking to invest?". This will shape the investment recommendations for the funds, but it could also impact the type of account you contribute into.

Traditional IRAs and employer retirement plans generally impose a 10% penalty on any distribution prior to age 59 ½. There are some exceptions to the penalty in IRAs, e.g., disability, qualified education expense, some medical expenses, etc., and 401(k) plans, e.g., loan options, special age 55 rule, etc., but dollars in these accounts are really intended to be long-term. Roth IRAs and Roth 401(k) accounts have the same age 59 ½ requirement for penalty-free distributions on earnings and contributions.

However, unique to Roth accounts is something known as the "5 year rule." We could spend an entire article discussing this somewhat complicated topic so for the sake of time, my advice would be to read more about this rule and strongly consider starting a Roth IRA or contribution into the Roth component of your 401(k) as early as possible to start what's known as the "5 year clock." Even if you only contribute \$100 to the account, establishing a Roth early can prove to be a wise move later on in life to avoid any unnecessary 10% penalties!

### **Flexibility Considerations**

As mentioned earlier, between the Roth IRA five-year-rule and strict 59 ½ age requirement for penalty free distributions, employer retirement plans, IRAs and Roth IRAs might not always be your best option as it relates to "withdrawal flexibility." If you desire more flexibility to pull funds out from an investment, an after-tax brokerage account might be your best bet. Because these accounts do not offer any tax deduction or tax deferral, there are no restrictions on when you can withdraw the funds invested.

### **Case Study**

Let's look at a hypothetical couple who are considering retirement around age 55. Given

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their future pension, Social Security benefits and large amount saved into their pre-tax 401(k)/IRA accounts (they each max out their respective 401(k) plans at work) and growing Roth IRA balances that we won't be able to tap into until age 59 ½, a possible recommendation would be to start saving more into their joint brokerage account. Moving forward, instead of contributing the maximum amount to each 401(k) plan, they will instead contribute 10%. This will ensure they receive the full company match on each plan and also receive a tax deduction on the contributions to keep them in the 22% tax bracket. The remaining amount that they would normally defer into their 401(k) plans, will now be deposited into their joint brokerage account.

Their brokerage account has been around for several years, however the balance is much lighter as compared to their Roth IRAs, IRAs and 401(k) plans. Building up the brokerage account balance over the next few years will offer them flexibility if they do in fact decide to retire almost five years before they'd be able to avoid the age 59 ½ penalty on their other accounts. Sure, they could draw some funds out of their Roth IRAs before age 59 ½, but this would only represent the amount they had contributed over the years. In most cases, it's advisable to preserve as much in Roth IRAs as possible, let the accounts grow and fully take advantage of the tax-free growth aspect of the account.

Is there any way to guarantee this is the perfect strategy for them? Of course not. If they decide to retire at age 60, it could have made more sense to continue maxing out the 401(k) plans. However, our job as advisers is to help clients achieve the goals they've shared with us while still maintaining a balance. Even if plans change, their financial plan will still be in great shape with them contributing to the brokerage account more over the next few years.

Like most things in life, finding a balanced approach when it comes to which retirement accounts you contribute to typically makes the most sense. There are some very well respected, intelligent advisers and thought leaders in our profession who strongly believe everyone should be making Roth contributions right now given our low tax environment. Our team and I don't subscribe to this extreme opinion. Life and circumstances change and, in our experience, there is never a one-size-fits-all strategy or approach in financial planning. Be sure to discuss this more with your adviser as you look to make 2025 a great year for your personal balance sheet.

### **About the author: Nick Defenthaler, CFP, RICP**

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Roth 401(k) plans are long-term retirement savings vehicles. Contributions to a Roth 401(k) are never tax deductible, but if certain conditions are met, distributions will be completely income tax free. Unlike Roth IRAs, Roth 401(k) participants are subject to required minimum distributions at age 72 (70 ½ if you reach 70 ½ before January 1, 2020). Matching contributions from your employer may be subject to a vesting schedule. Please consult with your financial adviser for more information.

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