IRAs: **TRADITIONAL** OR **ROTH?**

There are many factors to consider before deciding which IRA is right for you.

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The idea of tax-advantaged accounts for retirement savings has been around since 1974 when the Individual Retirement Account (IRA) was first introduced. The Roth IRA was part of the Taxpayer Relief Act of 1997.

The Roth IRA is another way for your retirement savings to grow tax-free. Both the traditional and Roth IRA have pros and cons, and, depending on your personal circumstances, one may be a better choice for you than the other.

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Common Features

Before we delve into the characteristics of the Roth 401(k), let's first review a few of the key features of both the "traditional" IRA and the Roth IRA, along with their differences.

TAX BENEFITS

A traditional IRA allows you to contribute earned income each year into an individual retirement account on a pre-tax basis. Subsequent distributions from the account are generally taxed at then-prevailing ordinary income tax rates. The Roth IRA is conceptually the reverse: the contributions are made with after-tax dollars, and the distributions — including any accrued income/gains — are generally tax-free.

CONTRIBUTIONS

Both traditional and Roth IRAs have limits on the amount and timing of contributions into the account. The Internal Revenue Service limits an individual's annual IRA contribution (into the taxpayer's traditional and Roth IRAs combined) to a certain fixed amount of earned income each year — e.g., $6,000 in 2020 and $7,000 if age 50 or older.[1] Within that limit, additional constraints may apply depending on the individual's adjusted gross income (see below). As a result of the SECURE Act, passed in December 2019, individuals can continue to contribute to traditional IRAs after they turn age 72 and have earned income.[1]

EARNED INCOME LIMITATIONS

When it comes to a traditional IRA, anyone with earned income even after age 70 ½ can contribute. With a Roth IRA, however, there are income-eligibility rules. Single tax filers must have a modified adjusted gross income (AGI) of less than $124,000 to contribute up to the contribution limit to a Roth IRA. Per the IRS, contribution limits are phased out (reduced) when modified (AGI) is $124,000 to $139,000. If you are married and filing jointly, you must have a modified AGI of less than $196,000 in 2020 in order to contribute to a Roth. Contribution limits are phased out (reduced) when modified AGI is from $196,000 to $206,000.[1]

WITHDRAWALS

With regard to distributions, only the traditional IRA has required minimum distributions (beginning at age 72) from the account. Both types of IRAs involve potential penalties if money is withdrawn before age 59½. Importantly, there are no forced distributions from the Roth IRA* — this additional deferral opportunity can be a significant advantage in terms of asset accumulation. Another benefit is tax-free distributions to beneficiaries. In the case of a regular IRA, your beneficiaries will pay the income tax on their required distributions.

Which IRA Makes Sense For You?

Whether a traditional or a Roth IRA is the better choice for you depends on a number of factors, such as your life expectancy, current and future income and tax brackets, cash needs in retirement, and the tax status of your beneficiaries. Your financial advisor can provide personalized advice. Generally speaking, for those in a high tax bracket today, the pre-tax contributions that can be made to a traditional IRA are highly beneficial in lowering annual income amounts for income tax purposes. Many people in this category will also benefit from a traditional IRA when withdrawing the funds at retirement since they will most likely be in a lower tax bracket (withdrawals from a traditional IRA are taxed at ordinary income tax rates).

Converting A Traditional IRA To A Roth IRA

Individuals also have the option of converting an already-established traditional IRA to a Roth IRA. Initiate the conversion only if it makes sense within your established long-term plan and goals. Basically, if you can't afford to pay the tax now — which is required if you convert to a Roth — it may not be for you. A Roth generally is most suitable for younger people who have more time to allow the Roth to grow, which helps make up for the large tax bite at the time of conversion.

The Roth 401(k)

Roth 401(k)s, first introduced in 2006, allow employers to add a Roth IRA-type feature to a 401(k) plan. This feature lets employees designate all or a portion of their 401(k) contributions as "designated Roth contributions." These contributions are held in a separate account from the employee's traditional 401(k), and handled similarly to a Roth IRA, i.e., contributions would not be tax-deductible, distributions are generally tax-free. Note that only employee elective deferrals may be added to the Roth 401(k) — employer matches and forfeitures cannot.

How does the Roth 401(k) differ from the Roth IRA? For one thing, contribution limits are higher. They are comparable to traditional 401(k) contribution limits ($19,500 in 2020; $26,000 if age 50 or older)[3] and there is no adjusted gross income limitation to phase out the employee's ability to contribute to a Roth 401(k). Similar to a regular 401(k), a Roth 401(k) is subject to required minimum distributions (RMDs), beginning at age 72. So, if an individual wants to leave assets to his or her heirs, the Roth 401(k) falls short as an estate planning tool due to these RMD requirements. However, once you are eligible to take a distribution from your Roth 401(k), you can roll the Roth 401(k) to a Roth IRA account. Once in the Roth IRA, there are no RMDs.

So, if an employer offers a Roth 401(k), does it make more sense than a traditional 401(k)? Once again, the answer depends on your particular situation. Adding to the list of factors we outlined in the IRA discussion, an employee should also consider expected work life, compensation level, current amount in a traditional 401(k), and expected rates of return.

One thing is clear: When it comes to deciding what kind of retirement savings tool is right for you, there is no substitute for careful analysis and consultation with your financial advisor.

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[1] *"The SECURE Act," House Commitee on Ways & Means."*

[2] *"Amount of Roth IRA Contributions That You Can Make for 2020"*

[3] *"What Are the Roth 401(k) Contribution Limits?" Investopedia.*

**Inherited IRAs are subject to different rules. Check with your financial advisor.*