Traditional versus Roth IRAs

Retirement

Each year, individuals with earned income may decide to put up to $7,500 ($8,600 if age 50 or older) into an IRA to save for retirement. The decision to contribute to a traditional IRA versus a Roth IRA has several key considerations, such as eligibility, tax deductibility, and current versus future tax rate. The below chart outlines some features of each type of IRA to aid in the important decision of which IRA to fund annually.

	Traditional IRA	Roth IRA
Tax-deductible contributions	Yes[1]	No
Tax-deferred growth on earnings	Yes	No
Tax-free growth on earnings	No	Yes
Tax-free distribution of earnings	No	Yes[2]
Contributions allowed at any age	Yes[3]	Yes[3]
Required minimum distributions (RMDs) at age 73	Yes	No
Contribution eligibility depends on income	No	Yes
Contributions may be withdrawn at any time tax-free	No[4]	Yes

[1] Dependent on tax filing status, retirement plan coverage, and modified adjusted gross income (MAGI)
[2] Five years from first Roth IRA funding and age 59 ½, first-time home buyer, death, or disability
[3] Must have earned income
[4] Non-deductible contributions may be withdrawn tax-free, but subject to the pro rata rule

Five important questions to ask

1. **Do I need a tax deduction, and am I eligible for it?**
   - **Single filers covered by an employer plan:** Full traditional IRA deduction if modified adjusted gross income (MAGI) < $81,000.
   - **Married filing jointly, covered by employer plan:** Full traditional IRA deduction if MAGI < $129,000.
   - **Not covered by employer plan (you/spouse):** Full traditional IRA deduction at any MAGI level.
2. **Am I eligible to make a Roth IRA contribution?**
   - **Single filer:** Full Roth IRA contribution ($7,500; $8,600 if 50+) if MAGI < $153,000.
   - **Married filing jointly:** Full Roth IRA contribution ($7,500; $8,600 if 50+) if MAGI < $242,000.
3. **Is my tax rate going to be higher now or higher in the future?**
   - If future tax rate is same or higher: Roth IRA is more beneficial-assets are tax-free after five years and age 59 ½.

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4. **Are my beneficiaries in high tax brackets?**
   - Most non-spouse beneficiaries must empty inherited IRAs within 10 years. If your beneficiary is in a high tax bracket, consider planning ahead to reduce their tax burden.
   - **High-tax bracket beneficiaries:** Inherited Roth IRA remains tax-free, regardless of beneficiary's tax rate, therefore the Roth IRA may be a better option.

5. **How long do I have until retirement or needing access to this money?**
   - **Younger investors:** Longer time horizon to compound IRA earnings.
   - Since Roth IRA earnings will eventually be tax-free, Roth IRAs become more appealing for younger investors.
   - Please Note: Withdrawals prior to age 59 ½ may be subject to taxes and a 10% penalty.

Bonus Question: Should I have a larger concentration of pre-tax or Roth IRAs?

- Large pre-tax IRA concentration: Subject to RMDs and taxes starting at age 73.
- **Tax diversified portfolio (pre-tax+Roth):** Provides flexibility to draw from both types and minimize tax liability.

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