roth vs. traditional ira

ROTH VS. TRADITIONAL IRA

While the bulk of your retirement investing may be done through your employer-sponsored retirement plan, the Individual Retirement Account (IRA) is still a popular choice. An IRA can be used in conjunction with an employer-sponsored plan, such as a 401(k).

There are two primary types of IRAs: Traditional and Roth. Both are designed to accomplish the same thing: wealth accumulation. But they go about it in very different ways from a taxation standpoint. Simply put, Traditional IRAs are taxed at the end and Roth IRAs are taxed at the beginning.

How a Traditional IRA works

Every year, a person is allowed to contribute a certain amount of money into a Traditional IRA. The amount is based on Internal Revenue Service (IRS) limits for both age and income of the contributor. If you are under 50 years old, you are allowed to contribute $5,500 into your IRA. If you are 50 years old or older, you are allowed an additional "catch-up" contribution of $1,000, bringing your total to $6,500.*

Contributions made into a Traditional IRA are tax deductible. This means you deduct the amount of your contributions from your income, thus lowering your taxable income. The less taxable income you have, the less tax you pay. Beyond that, you don't have to pay taxes each year as the IRA grows (assuming it grows). This concept is called tax deferral.

*As of 2015.

How a Traditional IRA is taxed

If you don't pay taxes at the beginning and you don't pay taxes along the way, then you know what's coming. With Traditional IRAs, you owe taxes when you make withdrawals. Your withdrawals are taxed as ordinary income.

Based on your income at withdrawal, you may be in a different tax bracket than you were in when you originally made your IRA deposits. This is either good or bad. If you're in a higher tax bracket at withdrawal, then you may end up paying more taxes on your IRA than you could have if you were to use a Roth IRA.

Since the government wants the tax revenue from your Traditional IRA, you must begin taking withdrawals from your IRA no later than age 70½. You can begin taking normal withdrawals at age 59½. If you make withdrawals prior to 59½, you are likely subject to a 10 percent penalty (unless your withdrawal falls under acceptable early withdrawal rules). Early withdrawals are available in the case of death, disability, qualified education expenses and the purchase of a first home. Check with your tax advisor for more information.

You can only make Traditional IRA contributions up to the year in which you turn 70½.

IRA deduction limits

2015 IRA deduction limits — Effect of modified Adjust Gross Income on deduction if you are NOT covered by a retirement plan at work

If your filing status is...	And your modified AGI is...	Then you can take...
SINGLE, HEAD OF HOUSEHOLD, OR QUALIFYING WIDOW(ER)	any amount	a full deduction up to the amount of your contribution limit
MARRIED FILING JOINTLY OR SEPARATELY WITH A SPOUSE WHO IS NOT COVERED BY A PLAN AT WORK	any amount	a full deduction up to the amount of your contribution limit
MARRIED FILING JOINTLY WITH A SPOUSE WHO IS COVERED BY A PLAN AT WORK	$183,000 or less	a full deduction up to the amount of your contribution limit
	more than $183,000 but less than $193,000	a partial deduction
	$193,000 or more	no deduction
MARRIED FILING SEPARATELY WITH A SPOUSE WHO IS COVERED BY A PLAN AT WORK	less than $10,000	a partial deduction
	$10,000 or more	no deduction

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.

Source: *http://www.irs.gov/Retirement-Plans/2015-IRA-Deduction-Limits-Effect-of-Modified-AGI-on-Deduction-if-You-Are-Covered-by-a-Retirement-Plan-at-Work*.

IRA deduction limits

2015 IRA deduction limits — Effect of modified Adjust Gross Income on deduction if you ARE covered by a retirement plan at work

If your filing status is...	And your modified AGI is...	Then you can take...
SINGLE OR HEAD OF HOUSEHOLD	$61,000 or less	a full deduction up to the amount of your contribution limit
	more than $61,000 but less than $71,000	a partial deduction
	$71,000 or more	no deduction
MARRIED FILING JOINTLY OR QUALIFYING WIDOW(ER)	$98,000 or less	a full deduction up to the amount of your contribution limit
	more than $98,000 but less than $118,000	a partial deduction
	$118,000 or more	no deduction
MARRIED FILING SEPARATELY	less than $10,000	a partial deduction
	$10,000 or more	no deduction

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.

Source: *http://www.irs.gov/Retirement-Plans/2015-IRA-Deduction-Limits-Effect-of-Modified-AGI-on-Deduction-if-You-Are-Covered-by-a-Retirement-Plan-at-Work*.

How a Roth IRA works

Every year, a person is allowed to contribute a certain amount of money into a Roth IRA. The amount is based on Internal Revenue Service (IRS) limits for both age and income of the contributor. If you are under 50 years old, you are allowed to contribute $5,500 into your IRA. If you are 50 years old or older, you are allowed an additional "catch-up" contribution of $1,000, bringing your total to $6,500.*

The contributions made into a Roth IRA are post tax. This means you have already paid taxes on this money and will never have to pay taxes on this money ever again, including any earnings.

Based on your income at withdrawal, you may be in a different tax bracket than you were in when you originally made your Roth IRA contributions. This is either good or bad. If you're in a higher tax bracket at withdrawal, then it worked in your favor.

You are never forced to take withdrawals from a Roth IRA. There are no Required Minimum Distributions (RMD).

You can make Roth IRA contributions at any age.

*As of 2015.

2015 Roth IRA contributions limits

If your filing status is...	And your modified AGI is...	Then you can contribute...
MARRIED FILING JOINTLY OR QUALIFYING WIDOW(ER)	< $183,000	up to the limit
	> $183,000 but < $193,000	a reduced amount
	> $193,000	zero
MARRIED FILING SEPARATELY AND YOU LIVED WITH YOUR SPOUSE AT ANY TIME DURING THE YEAR	< $10,000	a reduced amount
	> $10,000	zero
SINGLE, HEAD OF HOUSEHOLD, OR MARRIED FILING SEPARATELY AND YOU DID NOT LIVE WITH YOUR SPOUSE AT ANY TIME DURING THE YEAR	< $116,000	up to the limit
	> $116,000 but < $131,000	a reduced amount
	> $131,000	zero

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.

Source: *http://www.irs.gov/Retirement-Plans/2015-IRA-Deduction-Limits-Effect-of-Modified-AGI-on-Deduction-if-You-Are-Covered-by-a-Retirement-Plan-at-Work*.

ROTH VS. TRADITIONAL IRA

Your employer-sponsored retirement plan will likely be your main source for retirement planning, but IRAs are a great option to consider. The decision between a Traditional IRA and a Roth IRA is one your financial professional can help you make.

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