Retirement

TRADITIONAL VS. ROTH IRA

Presented for

Valued Client

Presented by

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TRADITIONAL VS. ROTH IRA

IRAs: The Purpose…

- Individual retirement accounts (IRAs) allow income earners—and in certain cases, their unemployed spouses—to save for retirement on a tax-deferred basis.
- No taxes are due until the IRA owner begins withdrawing funds, typically at retirement (Roth withdrawals may be tax free).
- An IRA may be either a traditional IRA or a Roth IRA.
- IRA contributions and earnings accumulate in a trust or custodial account, with a bank, federally insured credit union, savings and loan association, or other organization acting as trustee.
- Another option is an individual retirement annuity—generally subject to the same requirements, but following rules applying specifically to annuity contracts.

Allowable Contributions…

- Limits on annual contributions are the same for both traditional and Roth IRAs (or a combination of the two) and vary by age, year of contribution and income.
- In 2017, maximum contributions for IRA owners age 49 and under are $5,500. For those 50 and older, the maximum is $6,500.
- Contributions may not exceed 100% of earned income. For example, a 21-year-old with $3,500 in total earnings may only contribute up to that amount, not $5,500.
- An IRA owner may contribute to an IRA for a spouse who works part time or for a nonworking spouse.
- Combined yearly IRA contributions for both spouses can’t exceed their combined earnings for the year.
- Roth IRA contributions may be limited based on Modified Adjusted Gross Income (MAGI).
- A traditional IRA requires the owner to begin taking minimum distributions after age 70½. This doesn’t apply to lifetime Roth IRA distributions.

The Tax Picture…

- Traditional IRA contributions may be tax deductible, but Roth IRA contributions are not.

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- The maximum deduction in 2017 for a traditional IRA is $5,500 ($6,500 for individuals age 50 and over).
- A traditional IRA is subject to restrictions on who may take full advantage of the deduction. The full deduction is available for wage earners who are not active participants in other qualified retirement plans.
- For wage earners who are active participants in another retirement arrangement, the deductible amount is gradually phased out according to the person’s filing status and AGI. In 2017, the phase-out for single filers begins when AGI reaches $62,000, and the deduction is lost completely at $72,000. For married couples filing jointly, the 2017 phase-out amounts are $99,000 and $119,000, respectively.
- Roth IRA contributions are not tax deductible, but no federal income tax is due on distributions, provided certain requirements are met.
- In 2017, the phase-out reducing the allowable Roth contribution begins when a single filer’s AGI is between $118,000 and $133,000, and when a joint filer’s AGI is between $186,000 and $196,000. Single filers with AGI above $133,000 and joint filers above $196,000 may not contribute to a Roth IRA.
- If one spouse is covered by a qualified employer-sponsored retirement plan and the other is not, and their joint income is less than $186,000, the amount contributed to the non-covered spouse’s IRA would be fully deductible.
- Participation in another qualified retirement arrangement is not relevant with a Roth IRA. If the Roth IRA owner also owns a traditional IRA, the maximum contribution limit applies to the total contributions to both types of IRAs.

Distributions…

- IRA owners may begin taking distributions without tax penalty at age 59½. Earlier distributions are generally subject to a 10% penalty tax on the amount includible in gross income.
- Exceptions to the 10% penalty include distributions: (1) made when the owner dies or becomes disabled, (2) used to pay for qualified higher education expenses, (3) used to pay for qualifying first-time homebuyer expenses up to a $10,000 lifetime maximum, (4) set up as substantially equal periodic payments within the terms of the law, or (5) rolled over within 60 days.
- Traditional IRA distributions are taxed as ordinary income in the year they are received.

- IRA owners (including SEP, SIMPLE and Roth IRAs) can make only one “60-day rollover” from one IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs owned. Trustee-to-trustee transfers between IRAs and conversions of traditional IRAs to Roth IRAs are not limited.

The Bottom Line…

IRAs offer an effective, tax-advantaged way to save for retirement. Choosing between a traditional IRA and a Roth IRA in specific situations involves such considerations as the individual’s age, income and participation in qualified plan arrangements.

SUMMARY

What Is an IRA?

An individual retirement account (IRA) is an account available to people with earned income (and, in some cases, their non-working spouses) to set aside a portion of earnings for retirement. The tax treatment of the account differs between a traditional IRA and a Roth IRA.

With a traditional IRA, contributions are tax deductible, and tax is deferred on contributions and earnings until the money is withdrawn (typically at retirement).

With a Roth IRA, contributions are not tax deductible, but distributions are not taxed when withdrawn. Earnings on Roth contributions may also be withdrawn tax free under certain circumstances.

How Do IRAs Work?

The wage earner opens a trust or custodial account with a bank, a credit union, a savings and loan, or a brokerage firm. Another option is to purchase an individual retirement annuity contract.

In 2017, participants in traditional and Roth IRAs are subject to annual contribution limits of $5,500 for those age 49 and under, and $6,500 for individuals age 50 and over. The IRS limits contributions to 100% of earned income, if less than the dollar maximums. The IRS also limits contributions for nonworking spouses.

Are There Other Limitations?

Under a Roth IRA, the contribution amount may be limited or phased out depending on AGI and marital status. Under a traditional IRA, participation in an employer-sponsored retirement plan, such as a pension or 401(k) plan, may limit or phase out the deduction, depending on AGI and marital status.

How Are IRA Distributions Taxed?

Distributions from a traditional IRA are taxed as ordinary income to the extent they are attributable to tax-deferred contributions and earnings. Distributions from a Roth IRA are not taxed as long as certain requirements are met, since contributions were made with after-tax dollars. Distributions before age 59½ are subject to a 10% penalty tax unless certain exceptions apply. Traditional IRA owners can only contribute until the year they turn 70½ and must begin taking minimum distributions at age 70½. There are no requirements for Roth IRA owners, who may continue contributions after age 70½ even when they are still working.

The Benefits: A Summary

- Retirement benefits for workers and spouses
- Tax-deductible contributions to traditional IRAs, subject to limits and restrictions
- Tax-deferred growth for both types of IRAs
- Tax-free withdrawals from a Roth IRA (unless it is a conversion of a traditional IRA, in which case the 10% premature distribution tax may apply)
- No required minimum distributions from a Roth IRA during the owner's lifetime

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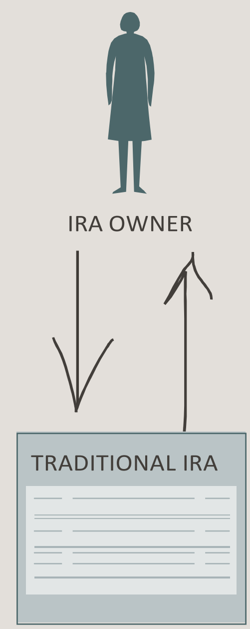
How a Traditional IRA Works

1

A worker or the worker's spouse establishes a traditional IRA and makes contributions within annual limits. Contributions are tax deductible for those not covered by an employer-sponsored retirement plan, or those with income below a certain level.

2

Contributions and earnings within the IRA grow tax deferred, allowing for greater accumulation.



3

The IRA owner may begin taking withdrawals from the plan at age 59½. Early withdrawals face a 10% penalty (with some exceptions). Withdrawals are taxed as ordinary income (although any nondeductible contributions may be withdrawn tax free).

4

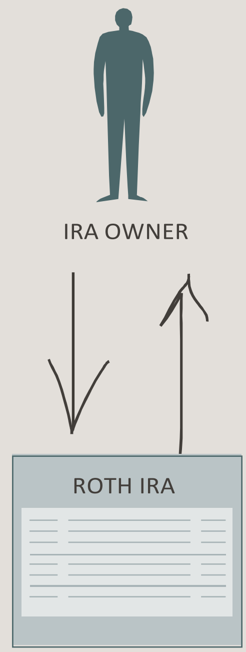
The IRA owner must start taking distributions by age 70½. After this date, a 50% penalty applies to any amount that should have been taken but wasn't.

TRADITIONAL VS. ROTH IRA

How a Roth IRA Works

1

A worker with adjusted gross income below a specified amount establishes a Roth IRA and makes contributions within annual limits. Contributions do not qualify for a tax deduction.



2

The IRA owner may withdraw contributions at any time without tax.

3

After the owner has had the IRA for at least five years, the owner may also withdraw earnings tax free—but only after age 59½, disability, death, or for qualified first-time homebuyer expenses. Early withdrawals face a 10% penalty (with some exceptions).

4

The IRA owner does not face required minimum distributions by age 70½. In fact, contributions may continue past age 70½ if the owner is still working.

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