

To Roth or not to Roth

In 1974 Congress enacted legislation to create the Individual Retirement Account (IRA). This legislation was designed primarily to provide a vehicle for retirement planning to the middle class worker who did not have an employer sponsored retirement plan. Since its inception the requirements, conditions, and parameters of the IRA have been revised many times. Although originally created to assist the worker with no employer provided retirement plan, the IRA has been expanded to allow workers who fall within certain income limits to supplement their employer provided retirement plans with their own through the use of the Individual Retirement Account (IRA). Designed primarily as a retirement vehicle for the middle class worker, the IRA came with some restrictions that kept it from being a suitable plan for some middle class workers and the worker who continued to work beyond normal retirement age. Some of these restrictions included:

1. Non-deductibility of contributions beyond limited income levels *
2. Excessive penalties for not taking Required Minimum Distributions after reaching age 70 ½
3. No contributions could be made after reaching age 70 ½.
4. Distributions are taxed at ordinary income tax rates.

* While non-deductible contributions are allowed at higher income levels and for certain workers who participate in employer provided retirement plans, earnings are still taxed at ordinary income rates and the other restrictions still apply.

Realizing the restrictions on the IRA, Congress passed legislation in 1998 to introduce the new ROTH IRA. Brainchild of Senator William Roth (R-DE), the ROTH IRA offered an alternative to the heavily restricted "Traditional" IRA. Some of its advantages over the Traditional IRA are:

1. All distributions are tax free
2. There are no Required Minimum Distributions
3. There are no age restrictions to contributions
4. Contributions can be withdrawn penalty free at any time

While some of the contributions to a Traditional IRA may be tax deductible, none of the contributions to a ROTH IRA are deductible in the year of contribution. Because all distributions from a ROTH IRA are tax free, the choice between a ROTH IRA and a non-deductible Traditional IRA becomes crystal clear. The benefits of the ROTH IRA far outweigh the benefits of a non-deductible Traditional IRA.

The decision then comes to the choice between a ROTH IRA and a deductible Traditional IRA. The decision between these two choices is not so clear. To determine which IRA would be best for you requires careful analysis of your current and potential future financial circumstances. If your current circumstances allow you to qualify for a deductible Traditional IRA, you need to determine if the immediate benefits for deducting your Traditional IRA contributions outweigh the long term potential of

forgoing an immediate tax deduction for the tax free distributions that a ROTH IRA offers. To say that one is better than the other is not the same for everyone.

For many years financial advisors advised investing in deductible Traditional IRA's over a ROTH IRAs on the premise that distributions received in your retirement years would be taxed at a lower tax rate than the income you are currently making. However, as time progresses more and more advisors are recommending the ROTH IRA over the Traditional IRA. My thoughts are that the answer is somewhere in between. There may be years when it may be more advantageous for you to contribute to a Traditional IRA and other years it may be more advantageous to contribute to a ROTH IRA. The fact is that you can have both types of IRAs and you could contribute to both of them in the same year if you wanted to. The only restriction is the total amount that you can contribute each year to your IRAs.

Proper tax planning and investment strategy should be the controlling factors when determining the best course of action for your circumstances. Since a detailed discussion on all the rules and requirements of each IRA is beyond the scope of this monthly newsletter, I recommend seeking the advice of a knowledgeable tax advisor to assist you with the decision concerning your IRA choices.

If on the other hand you are a "do it yourselfer", then a careful review of IRS Publication 590 is mandatory to understand the rules and requirements for each IRA. In addition, you can gain a great deal of guidance by visiting the websites of many of the major investment firms such as Fidelity, T. Rowe Price, Vanguard, etc.

Til next time,

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