Roth Vs. Traditional IRA: Which Is Right For You? | Investopedia

As U.S. taxpayers contemplate funding IRAs, they may wonder which type of IRA - Roth or Traditional – is the better choice. If you are one of these individuals, here is an outline of some of the differences between these two retirement accounts, their eligibility requirements and other factors to consider when choosing the account that's right for you.

Contribution Limits

The contribution limits for the Roth and traditional IRAs are the same. For tax year 2016, for example, you can contribute up to $5,500 to your IRA, plus an additional $1,000 catch-up contribution if you reached age 50 or older by the end of the tax year.

Deductibility

One of the major factors for deciding between a Roth and traditional IRA is your eligibility to deduct traditional IRA contributions and in turn get a tax break for the year you make the contribution. Your eligibility to deduct traditional IRA contributions, however, depends on whether you meet certain requirements. Contributions to Roth IRAs are never deductible. (For additional insight, read *Can You Deduct Your IRA Contributions?*)

Contribution Age Limits

If you want to be able to contribute to your IRA for as long as you like, you need to consider the age limits placed on IRA contributions. You may not make a participant contribution to a traditional IRA for the year you reach 70½ and after. For Roth IRAs, there is no age limit.

Income Limitations

One factor that determines whether you should fund a Roth or traditional IRA is your income, which dictates your eligibility to contribute to a Roth IRA. If your income exceeds certain limits, you may not contribute to a Roth IRA. In addition, your Roth IRA contribution limit may be lowered if your income falls within certain ranges. Consult with your tax advisor to determine the maximum amount you may contribute to a Roth IRA. (For more insight, see *An Introduction To Roth IRAs*.)

Income caps do not apply to traditional IRA contributions.

Required Minimum Distributions

If you don't ever want to be required to start distributing your retirement assets at any time, you need to consider the IRA rules for required minimum distributions (RMD). With a traditional IRA, you must begin to take RMDs by April 1 of the year following the year you reach age 70½. This means you must gradually reduce your IRA balance and add the distributed amount to your income, even if you are not in need of the funds.
Roth IRA owners are not subjected to RMD rules. (For more insight, see *6 Important Retirement Plan RMD Rules*.)

Tax Treatment of Distributions

The tax treatment of distributions is another factor that determines whether the Roth or traditional IRA is better for you. Generally, distributions from a traditional IRA are treated as ordinary income and may be subject to income taxes; furthermore, the distributed amount may be subjected to early-distribution penalties if the amount is withdrawn while you are under the age of 59½.

On the other hand, qualified Roth IRA distributions are tax and penalty free. Roth IRA distributions are qualified if they meet the following two requirements:

1. The distributions are taken no earlier than five years after you fund your first Roth IRA. This five-year period begins with the calendar year for which the first contribution is made.
2. The distribution is taken as a result of any one of the following:
   – You have reached age 59½.
   – You are disabled.
   – Your beneficiary receives the distribution upon your death.
   – The amount is used to purchase a first home (subject to a lifetime limit of $10,000).

From a general tax perspective, the Roth IRA is the better choice if your tax rate during retirement will not be lower than your current tax rate, as the Roth IRA allows you to pay the taxes now and receive tax-free distributions when your income tax rate is higher. If your tax rate will be lower during retirement, then the traditional IRA may be the better choice if you are eligible to receive a tax deduction now when your tax rate is higher.

Your financial planner should be able to help you determine whether there are other factors to consider that would make either IRA more suitable for your retirement planning needs.

Splitting Your Contribution

If you are eligible to contribute to both types of IRAs, you may divide your contributions between your

Roth and traditional IRA. However, your total contribution to both IRAs must not exceed the limit for that tax year (including the catch-up contribution if you're 50 and over).

If you decide to split your contributions between both types of IRAs, you may choose to contribute the deductible amount to your traditional IRA. (For more insight, see *Traditional IRA Deductibility Limits*) and the balance to your Roth IRA.

Before splitting your IRAs, however, consider additional fees, such as maintenance fees charged by your IRA custodian/trustee for maintaining two separate IRAs. Note also that placing bulk trades into one IRA instead of placing separate trades in separate IRAs could help you save on trade-related fees. Finally, consider the short-term benefits as well as the long-term benefits and decide which outweighs the other.

Summary

The following chart summarizes the similarities and differences between the Roth and traditional IRAs:

	Roth IRA	**traditional IRA**
Contribution Limit	The year's regular contribution limit plus a catch-up contribution for those at least 50 years old by year end.	The year's regular contribution limit plus a catch-up contribution for those at least 50 years old by year end.
Deductibility	Contributions are never deductible.	Contributions may be deductible, depending on tax-filing and active-participant statuses, as well as income amount.
Age Limitation	No age limitations on contributions.	No contributions allowed after and for the year the taxpayer attains age 70½.
Tax Credit	Available for ‘saver’s tax credit.’	Available for ‘saver’s tax credit.’

	credit.	
Income Caps for Contributions	Income caps may prevent taxpayers from contributing.	No income caps will prevent taxpayers from contributing
Treatment of Earnings on IRA Investments	Earnings grow tax deferred. Qualified distributions are tax free, including distribution of earnings.	Earnings grow on a tax-deferred basis. Earnings are added to taxable income for the year distributed.
Distributions Rules	Distributions may be taken at any time. Distributions are tax and penalty free if qualified.	Distributions may be taken at any time. Distributions will be treated as ordinary income and may be subjected to an early-distribution penalty if withdrawn while the owner is under the age of 59½.
Required Minimum Distribution	Owners are not subject to the RMD rules. However, beneficiaries are subject to the RMD rules.	IRA owners must begin distributing minimum amounts beginning April 1 of the year following the year they turn age 70½. Beneficiaries are also subject to the RMD rules.

Deciding Which Is Better

For some taxpayers, their eligibility to deduct traditional IRA contributions is the main deciding factor in choosing between a Roth and traditional IRA. However, being eligible to deduct your contribution does not mean that the traditional IRA is your better choice. Consider whether the benefits of the Roth IRA – such as freedom from the RMD rules and taxes, and penalty-free distributions – outweigh the benefits of a deduction.

The Bottom Line

You may contribute to a Traditional IRA and elect not to claim the tax deduction even though you are eligible to do so. The benefit of not taking a deduction is that the distribution of the equivalent amount is tax and penalty free – like the distributions of the Roth IRA. The earnings distributed from the Traditional IRA, however, will be treated as taxable income, whereas qualified distributions of earnings from a Roth IRA are tax free.

Finally, you may split your contribution between both types of IRAs and enjoy the benefits of both.

Be sure to consult with your tax professional, as there are usually other factors that could determine which options are most suitable to meet your financial needs. For background, see *IRAs: Advantages, Disadvantages and Which One Is Right for You?*