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 the funds, typically at retirement (Roth withdrawals may be tax free).
- The 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.
- Maximum contributions for persons age 49 and under are $5,500 in 2017. For persons age 50 and older, the maximum is $6,500 in 2017.

- Contributions may not exceed 100% of earned income. Example: A 21-year-old with $3,500 total earnings in 2017 may only contribute up to that amount, not $5,500.
- An IRA owner may contribute to an IRA for a nonworking or part-time working 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 (AGI).
- A traditional IRA requires owners 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.
- The maximum deduction for traditional IRA contributions corresponds to the maximum allowable contribution. Example: The maximum deduction in 2017 for a traditional IRA is $5,500 ($6,500 for age 50 and up).
- 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. Examples are employer-sponsored retirement plans, 401(k) and 403(b) plans, SEPs and SIMPLE 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 the 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 when distributions are made, provided certain requirements are met.

- ❖ In 2017, the phase-out reducing the allowable 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 qualified employer-sponsored retirement plan but 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.
- ❖ Possible 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 it is made.
- ❖ IRA owners (including SEP, SIMPLE and Roth IRAs) can make only one "60 day" rollover from an 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 to Roth IRAs are not limited.

The Bottom Line...

IRAs offer effective, tax-advantaged ways 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 other qualified arrangements.

Graphic: How a Traditional IRA Works

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1. The owner establishes a traditional IRA and makes annual contributions.

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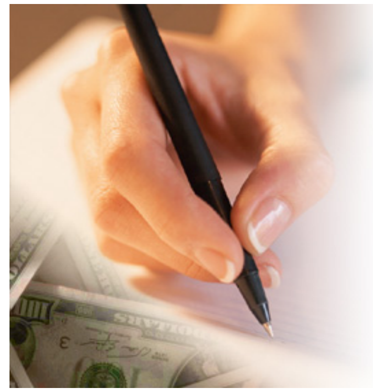

3. Withdrawals at retirement are generally taxed as ordinary income in the year received, with any nondeductible contributions recovered tax-free.

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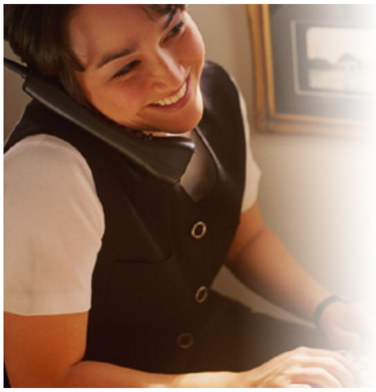
2. Contributions are generally tax-deductible for participants who either aren't covered under an employer-sponsored retirement plan or have income falling below specified yearly levels, and contributions and earnings in the IRA grow tax-deferred.

Benefits paid prior to age 59½ can incur a 10% penalty tax unless an exception applies.

Distributions must begin no later than April 1 of the year following the year when the participant reaches age 70½. There's another tax penalty—equal to 50% of the amount that should have been taken but wasn't—for not taking required minimum distributions each year once the trigger date occurs.

Graphic: How a Roth IRA Works



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1. Income earners with adjusted gross incomes below specified amounts can make contributions to a Roth IRA up to specified annual maximums.

2. The contributions are nondeductible.

3. Contributions may be withdrawn at any time without tax. After the Roth IRA has been in effect for at least five tax years, tax-free withdrawals of earnings may be made once the owner reaches age 59½, dies, or is disabled. Earlier withdrawals may be taken for first-time homebuyer expenses up to a $10,000 lifetime maximum.

4. Roth IRA withdrawals may be received income tax-free, subject to certain limitations and a possible 10% penalty tax on early withdrawals.

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