

Roth or Traditional IRA: Which Is Right For You

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So you're thinking about opening an IRA but you're not sure whether a Traditional IRA or a Roth IRA is right for you. People often ask which is 'better'. The answer is... it depends.

When it comes to deciding on a Roth or Traditional IRA, there are a few questions you'll want to ask yourself. The first question is... do I want to pay taxes now or later? Roth and Traditional IRAs have significantly different tax rules. With a Traditional IRA, you can deposit into your account using pretax dollars, but you pay taxes on the principal and earnings when the money is withdrawn. Contributions to your Roth IRA must be after tax funds, but you won't have to pay taxes on the principal or the earnings when the money is withdrawn. When you deposit into your Traditional IRA using pretax dollars, it may reduce your taxable income, which will give you a bit of a tax break. Not so with the Roth, but remember with the Roth you may earn money on the funds you contributed that will never be taxed. So the question becomes - do you need the income tax break now? Or can you forgo the taxbreak for the prospect of taxfree earnings later?



The second question you'll want to ask yourself is, at what age do I think I'll need the funds I'm planning to put in this account? In addition to strict tax rules, IRAS also have some age requirements. Withdraws from both IRAs begin at age 59 1/2. With a Traditional IRA, withdraws are mandatory by age 70 1/2. With a Roth IRA, there is no mandatory distribution age. If you don't foresee needing the money in your IRA account until 75 or even 80, the Roth IRA might be the better option for you.

The third question you want to ask yourself is - might I need to withdraw this money before retirement? There is a difference in how early withdrawals are handled with each IRA. When you withdraw money early from a traditional IRA you will have to pay taxes and a 10% penalty on both the contributions to that account and the earnings. If you take an early withdrawal from your Roth IRA, you will pay taxes and a 10% penalty on the account earnings only. Not the contributions. (There are exceptions for both accounts which will allow you to take an early withdrawal penalty free). If you think there is a possibility you may need to withdraw this money before age 59 1/2, withdrawing from a Roth may be less costly.

One final thing to keep in mind is, there are income limits. For tax year 2012, you may open a Roth IRA only if your adjusted gross income is less than \$125,000 if you are a single filer and \$179,000 if you are married and file jointly. If you don't meet those requirements, you won't be eligible to open a Roth IRA.

So you can see why there is no easy answer to this question. Sit down with a nice cup of tea and weigh the variables. Use these questions as a starting point. And if all else fails, contact your tax accountant.