

IRAs and Retirement: What You Need to Know

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The type of individual retirement account you choose can significantly affect you and your family's long-term savings. Knowing the differences between Traditional IRA and Roth IRA accounts is key.

One important point to remember is that a company sponsored qualified plan usually will be your first choice for retirement savings, since the savings limits are greater. If you are a sole proprietor, you can choose a Solo 401K or SEP IRA as the first choice for your retirement savings. Then adding an IRA or Roth IRA would supplement your savings plan. Here are some key considerations for a traditional IRA or Roth IRA.

Income Limits. Anyone with earned income, who is younger than 70½, can contribute to a traditional IRA. Roth IRAs, however, have income-eligibility restrictions: Single tax filers, for instance, must have modified adjusted gross incomes (AGIs) of less than \$137,000 in 2019 to contribute to a Roth IRA. (Contribution limits are phased out starting at \$122,000 in modified AGI, per IRS guidelines.) Married couples filing jointly must have modified AGIs of less than \$203,000 in 2019 in order to contribute to a Roth; contribution limits are phased out starting at \$193,000.

Tax Incentives. Both traditional and Roth IRAs provide generous tax breaks, but it's a matter of timing when you get to claim them. Traditional IRA contributions are tax deductible on both state and federal tax returns for the year you make the contribution, while withdrawals in retirement are taxed at ordinary income tax rates. Roth IRAs provide no tax break at the time of contribution, but earnings and withdrawals are generally tax-free. So, with traditional IRAs, you avoid taxes when you put the money in – and with Roth IRAs you avoid taxes when you take it out in retirement.

Future Tax Rates. Do you expect your income to increase or decrease in retirement? Deciding to contribute to a traditional or Roth IRA generally depends on whether you expect your income tax rate in retirement to be higher or lower than what you currently pay. That's because it determines whether the tax rate you pay on your Roth IRA contributions (today's tax rate) is higher or lower than what you'd pay on your traditional IRA's withdrawals in retirement.

Of course, it's hard to predict what federal and state tax rates will be 10, 20 or even 40 years from now, but you can ask yourself some

basic questions to help determine your personal situation: Which federal tax bracket are you in today? Do you expect your income, including Social Security, to increase or decrease in retirement?



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Although conventional wisdom suggests that gross income declines in retirement, taxable income sometimes does not. Think about it. Once the kids are grown and you stop saving for retirement, you lose some valuable tax deductions and tax credits, possibly leaving you with higher taxable income in retirement.

Given today's historically low federal tax rates and large U.S. deficit, many economists believe federal income tax rates will rise in the future, meaning Roth IRAs may be the better long-term choice.

Many things can affect your future tax rate in retirement besides increases in federal taxes. If you are a business owner, and part of your retirement planning is selling your ownership, that additional income could increase your tax bracket and taxes on your IRA distributions. In short, distributions from a Roth IRA likely will not be affected by changes in your income or tax rates.

Withdrawal Rules. One other major difference between traditional IRAs and Roth IRAs is when the savings must be withdrawn. Traditional IRAs

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require you to start taking required minimum distributions (RMDs) the first of April after you turn 70 ½. Roth IRAs, on the other hand, don't mandate withdrawals during the owner's lifetime. So, if you don't need the money, Roth IRAs can continue to grow tax-free throughout your lifetime, making them ideal wealth-transfer vehicles. Beneficiaries of Roth IRAs don't owe income tax on withdrawals and can stretch out distributions over many years. However, beneficiaries still may owe estate taxes.

Extra Benefits and Considerations. It's also worth factoring in some of the specific rules and benefits of traditional and Roth IRAs. Here's a breakdown:

Traditional IRAs

- Contributions to traditional IRAs lower your taxable income in the contribution year. That lowers your adjusted gross income, helping you qualify for other tax incentives you wouldn't otherwise get, such as the child tax credit or the student loan interest deduction.
- Up to \$10,000 can be withdrawn without the normal 10% early-withdrawal penalty to pay for qualified first-time homebuyer expenses. However, you'll pay taxes on the distribution.

Roth IRAs

- Roth contributions (but not earnings) can be withdrawn

penalty- and tax-free any time, even before age 59 ½.

- Five tax years after the first contribution, you can withdraw up to \$10,000 of Roth earnings penalty-free to pay for qualified first-time homebuyer expenses.

Keep in mind that Congress can change these rules at any time. While these are the rules today, they may be different when you retire. ▲

Vicki Fillet is available to help with Selected members' financial planning needs . She can be reached at 646-452-6731.

	Roth IRA	Traditional IRA
2019 Contribution Limits¹	\$6,000; \$7,000 (if age 50 or older)	\$6,000; \$7,000 (if age 50 or older)
2019 Income Limit¹	Single tax filers with modified AGIs of less than \$137,000 (phase-out begins at \$122,000); married couples filing jointly with modified AGIs of less than \$203,000 (phase-out begins at \$193,000)	Anyone with earned income can contribute, but tax deductibility is based on income limits and participation in employer plan
Tax Treatment	No tax break for contributions; tax-free earnings and withdrawals in retirement	Tax deduction in contribution year; ordinary income taxes owed on withdrawals
Withdrawal Rules	Contributions can be withdrawn at any time, tax-free and penalty free. After five years and age 59½, all withdrawals are tax-free, too. No withdrawals required during account holder's lifetime; beneficiaries can stretch distributions over many years	Withdrawals are tax-free and penalty free beginning at age 59½. Distributions must begin at age 70½; beneficiaries pay taxes on inherited IRAs.
Extra Benefits	After five years, up to \$10,000 of earnings can be withdrawn penalty-free to cover first-time homebuyer expenses.	Contributions lower taxpayer's AGI, potentially qualifying them for other tax incentives; up to \$10,000 penalty-free withdrawals to cover first-time homebuyer expenses, but taxes due on distributions.

¹ 2019 Limitations Adjusted As Provided in Section 415(d), etc. Retrieved July 10, 2019, from [irs.gov/pub/irs-drop/n-18-83.pdf](https://www.irs.gov/pub/irs-drop/n-18-83.pdf)