

To IRA or Roth IRA?

Quick Notes...

Individual retirement accounts are personal savings plans that offer tax advantages to set aside money for retirement.

Qualified individuals can contribute up to \$2,000 into an IRA, Spousal IRA, or Roth IRA.

Contributions to an IRA are generally tax deductible, while distributions from a Roth IRA are tax free.

We all share the goal of a comfortable retirement. But how many of us realize that achieving this goal will most likely depend, at least in part, on our personal savings? Social Security and company pension benefits will not likely provide the level of income required to maintain the same standard of living in retirement that we are accustomed to in our working years.

Individual Retirement Accounts

Individual retirement accounts (IRAs) are personal savings plans that offer tax advantages for saving money for retirement. Accounts can be established through most financial institutions, brokerages houses, mutual funds, and life insurance companies.

Individuals and married couples with two wage earners may each contribute up to \$2,000 into an IRA. Married couples with one wage earner may contribute up to a total of \$4,000 into an IRA and a Spousal IRA. The combined contributions can be split between the IRA and Spousal IRA – as long as the contribution to either IRA does not exceed \$2,000 per tax year and the total does not exceed the couple's combined income.

Contributions to an IRA are generally tax deductible. However, if the taxpayer or spouse participate in an employer sponsored retirement plan at any time during the year, allowable IRA deductions may be reduced or eliminated. For married people filing a joint return, IRA deductions are reduced by 20% if their modified adjusted gross income is between \$40,000 and \$50,000 and eliminated if modified adjusted gross income exceeds \$50,000. (Recent legislation will cause these limits to increase in future years).

Generally, withdrawals from an IRA can not be made prior to the owner reaching age 59 ½, and must begin once the owner reaches age 70 ½. Any premature withdrawals not used for specific, allowable expenses are subject to a 10% tax in addition to any applicable income taxes.

Roth IRAs

The Taxpayer Relief Act of 1997 created a new investment vehicle called the "Roth IRA," which becomes available to individual taxpayers beginning in 1998. Contributions to Roth IRAs are not tax deductible, but principal and interest are tax free when withdrawn.

Individual taxpayers and spouses may each contribute up to \$2,000 per year into a Roth IRA. Eligibility for Roth IRAs does not consider employer sponsored retirement plans and begins to phase out at income levels of \$95,000 to \$110,000 for individuals and \$150,000 to \$160,000 for married couples filing a joint return.

Earnings cannot be withdrawn until the account has been held for five years and the owner reaches age 59 ½, dies, or becomes disabled; the distributions are used for first time home purchases (subject to a \$10,000 lifetime cap); or the distributions are used for qualified higher education expenses.

IRA assets may be converted (rolled over) into a Roth IRA in any year in which the

taxpayer's modified adjusted gross income does not exceed \$100,000. The 10% additional tax on premature distributions is not applicable, but income taxes must be paid at current rates on the amount rolled over. However, conversions that occur in 1998 may be spread over a four-tax-year period.

It is important to remember that all tax laws have unique applications to individual situations, and IRAs and Roth IRAs are no different. Furthermore, there are many ambiguities in the new tax law that have yet to be cleared up by Congress and IRS interpretations and court cases.

Taxpayers should consult with their tax professional before investing in (converting to) a Roth IRA. Also, *IRS Publication 590, Individual Retirement Arrangements (IRAs)* and special financial software can provide additional information. Such software is available at varying prices from certain mutual fund companies, financial management companies, and financial software developers.

A Comparison of Investment Vehicles.

	"Savings Account"	Regular IRA	Roth IRA
Annual Investment ¹	\$2,000	\$2,000 ³	\$2,000
Balance at End of 10 Years (Before Lump Sum Distribution)			
15% annual tax rate	\$29,946	\$32,192 (+ \$3,000 in tax savings)	\$32,192
28% annual tax rate	\$28,133	\$32,192 (+ \$5,600 in tax savings)	\$32,192
Balance at End of 10 Years (After Lump Sum Distribution)			
15% final tax rate	\$29,946	\$31,855 (-\$27,363 + \$4,492) ³	\$32,192
28% final tax rate	\$28,133	\$31,055 (-\$23,178 + \$7,877) ³	\$32,192
¹ Assumes that (a) the taxpayer is eligible to invest in each type of investment vehicle; (b) annual contributions are made on the first day of the year; and (c) the average annual growth rate equals 8.50%. ² An individual whose marginal tax rate is 15% would save \$300 and an individual at the 28% marginal tax level would save \$560 each year because regular IRA contributions are tax deductible in the year made. ³ The amount of money in the regular IRA plus the earnings from investing the tax savings in a taxable account yielding 8.50%.			

A Comparison of Individual Retirement Accounts and Roth Individual Retirement Accounts.¹

	IRA	Roth IRA
Contribution Eligibility	<p>Taxpayers</p> <ul style="list-style-type: none"> • less than 70 ½ years of age; • having taxable compensation; and • not an active participant in an employer sponsored retirement plan. <p>Eligibility phases out when adjusted gross income is between:</p> <ul style="list-style-type: none"> • \$25,000 - \$35,000 for singles (\$30,000 - \$40,000 in 1998). • \$40,000 - \$50,000 for married couples (\$50,000 - \$60,000 in 1998). <p>Maximum annual contribution is the lesser of:</p> <ul style="list-style-type: none"> • \$2,000 • 100% of taxable compensation. <p>Non-employed spouses may also contribute up to \$2,000 as long as the total of both contributions does not exceed the couple's combined income.</p>	<p>Taxpayers</p> <ul style="list-style-type: none"> • of any age; and • having taxable compensation. <p>Eligibility phases out when adjusted gross income is between:</p> <ul style="list-style-type: none"> • \$95,000 - \$110,000 for individuals. • \$150,000 - \$160,000 for married couples. <p>Maximum annual contribution is the lesser of:</p> <ul style="list-style-type: none"> • \$2,000 • 100% of taxable compensation. <p>Non-employed spouses may also contribute up to \$2,000 as long as the total of both contributions does not exceed the couple's combined income.</p>
Tax Deductibility of Contributions	<p>Tax deductible if adjusted gross income does not exceed eligibility phase-out incomes.</p> <p>Tax deductible if taxpayer and spouse do not participate in employer sponsored retirement program(s). Beginning in 1998, spouse's participation in such plans is irrelevant.</p>	Not tax deductible.
Earnings	Taxable at time of withdrawal.	Tax free, if held for five years.
Distributions	<p>May begin at age 59 ½, and must begin at age 70 ½.</p> <p>Taxable at current income tax rates and 10% additional tax unless used for:</p> <ul style="list-style-type: none"> • College; • First time home purchase; and • Certain unreimbursed medical expenses and medical insurance premiums. 	<p>May begin at age 59 ½.</p> <p>Tax free if held for five years and the distribution is made:</p> <ul style="list-style-type: none"> • After the owner reaches age 59 ½ • To the beneficiary after the owner's death; • After the owner becomes disabled; • For first time home purchases; and • For higher education expenses.

¹ According to information available and known as of 1 November 1997.

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