Which IRA Is Right For You?

The individual retirement account (IRA) is celebrating its golden anniversary. Created in 1974, this savings vehicle has helped millions of people build resources for retirement. And in 1997, the Roth IRA was introduced. But which IRA is right for you?

Let's look at the basic differences between the two IRAs. With a traditional IRA, you generally invest pretax dollars, so the more you put in, the lower your taxable income. Your earnings grow tax deferred, meaning you pay no taxes on them until you start taking withdrawals. (If you take withdrawals before you reach 59½, you'll be subject to ordinary income tax and a 10% IRA penalty.)

When you invest in a Roth IRA, your contributions aren't deductible, but they can be withdrawn at any time, tax- and penalty-free. And you can typically withdraw your earnings on these contributions tax free once you're 59½ and you've had your account at least five years. (If you don't meet these conditions, withdrawals of earnings are subject to income taxes and the 10% penalty.)

So, are you better off by taking the immediate tax break offered by a traditional IRA or the long-term benefits of tax-free withdrawals available with a Roth IRA?

If you think you'll be in a higher tax bracket when you retire, you might want to consider a Roth IRA, especially if you have a long time until retirement. This will give you more opportunities to put away funds that can be withdrawn tax free. Conversely, if you think you might be in a lower tax bracket upon retirement, you might lean toward a traditional IRA, as you'd get the tax benefits now, when you're in a higher bracket, and can eventually make your taxable withdrawals when you're in a lower one.

Here's something else to keep in mind: Once you turn 73 (or 75 if you were born in 1960 or later), you must start taking taxable withdrawals — technically called required minimum distributions, or RMDs — from your traditional IRA. But if you have a Roth IRA, you won't face RMDs and can essentially keep the money in your account indefinitely. If you don't need all the funds in your Roth IRA for your retirement, you can pass them on to your heirs.

Ultimately, though, your income may determine which IRA is right for you. You can earn any amount and contribute to a traditional IRA, though if you exceed certain income limits, your contributions may no longer be tax deductible. If you and your spouse don't have a 401(k) or other retirement plan through your employers, you can make a full, deductible contribution to a traditional IRA regardless of your income.

But you may not be able to contribute to a Roth IRA, or at least not make the full maximum annual contributions, if your income is above certain levels. Your tax advisor can explain these levels, which often increase from year to year. (In 2024, the most you can contribute to either IRA, depending on your income, is $7,000 per year, or $8,000 if you're 50 or older.)

Under some circumstances, you can convert a traditional IRA to a Roth IRA, though you'll need to pay taxes on the conversion. In any case, think carefully about your options and make the choices that are appropriate for your needs.

This article was written by Edward Jones for use by your local Edward Jones Financial Advisor.

Edward Jones, Member SIPC

5 – Oct. 28, 2024
550 words