

## Roth or Traditional IRA, Which? ©

Unfortunately the answer to this question is not straightforward. We provide an explanation of the issues below, but regardless of what you read here or elsewhere, you still need to use a calculator to actually profile your situation. Two excellent and free Roth vs. Traditional IRA calculators are available at [www.IRACentral.com](http://www.IRACentral.com). Use either the "Roth IRA Conversion" calculator for analysis on converting from a Traditional to a Roth, or use the "Roth vs. Traditional IRA" calculator for analysis in setting up a new account. To find the calculators, click on the "IRA & Retirement Calculators" link at IRACentral.com.

The Roth IRA has the potential to be much more powerful and flexible than the Traditional IRA because:

1. The entire Roth account grows tax free, not just tax deferred, but tax free. You never pay taxes on growth, income or withdrawals, though you do pay taxes on the money you earned to generate the contributions which you invest in the Roth.
2. After the plan has existed for 5 years, the Roth allows you to make withdrawals (distributions) at any age or amount, and withdrawals will be both penalty and tax-free. (But note that you may also take partial withdrawals from a Traditional IRA at any pre-retirement age by using an IRS provision called "72(t)". For complete information go to [www.IRACentral.com](http://www.IRACentral.com) and click on the link "Access Your IRA for Quick Cash".)
3. You are not required to take mandatory distributions at age 70½ with a Roth. You may take distributions at any time, or never take them and leave the whole account to your heirs. Heirs will also have a completely income tax free usage of money in the Roth.

From a general tax perspective, the Roth IRA is the better choice if your tax rate during retirement will be equal to or higher than your current tax rate, since the Roth IRA allows you to pay the taxes now and receive tax-free distributions when your income tax rate may be higher.

Converting from a Traditional IRA to a Roth can make good economic sense if your Traditional has lost a lot of money. This means there is much less to tax upon conversion (see the "Notice" topic below).

Generally speaking, you would likely want a Traditional IRA if you need the tax deduction now, and/or if you anticipate paying taxes in retirement at a rate which is significantly lower than what you pay now. The tax savings as you invest in a Traditional IRA may be enough to get your current income taxed in a lower tax bracket. And, often your income is lower in retirement years, so you may have a lower tax rate when you withdraw your money. It's possible that the tax deductibility of contributions to a Traditional IRA will give you a better result than paying the taxes first and then putting the rest in a Roth IRA.

A Traditional IRA is mandatory if you use the SEP-IRA; the Roth is not allowed in this plan. The SEP-IRA is a highly advantageous IRA to which small business employers can contribute up to \$49,000 per year, per employee. Business owners are included under SEP-IRA rules, even in cases where the business owner is a sole employee. For more complete SEP-IRA information, go to [IRACentral.com](http://IRACentral.com) and click on the SEP-IRA link.

Finally, the choice between Roth vs. a traditional IRA will be effected your age. Being closer to retirement will likely mean that you will receive less benefit from a Roth than you would get by starting or converting to a Roth at a younger age.

**Notice About Tax Issues With Roth Conversions.** Be sure you understand that if you do a Traditional to Roth conversion you will be taxable at current income tax rates on the full amount converted (though the Roth will never be income taxable again). This means that converting a \$50,000 IRA to a Roth will add \$50,000 of taxable income on your next tax return (or on your quarterly tax estimates). If all of that \$50,000 is in a 25% tax bracket, you will pay \$12,500 in additional federal taxes for the year, plus state taxes, as a result of the conversion.

It is completely legal and normal, though, to do a Roth conversion in multiple steps to limit the amount of taxation per year, and also to keep the taxed amount in the lowest tax bracket. For example, instead of converting the whole

\$50,000 in one year you might convert \$10,000 per year for each of five years. If limiting the conversion to \$10,000 per year keeps you in a lower bracket, say 15% instead of 25%, then that is a very worthwhile benefit over making the entire conversion in one year. In all cases you should use the free calculators in the first paragraph of the above topic to estimate the benefits and taxes, and you should consider consulting with a tax professional to make sure you have an advance understanding of the conversion taxes you will owe.

**How To Do A Traditional To Roth IRA Conversion.** If you decide that converting your existing Traditional IRA to a Roth makes sense, the actual process with an IRA custodian is or should be fairly easy. If that doesn't appear to be the case you may benefit by switching your Traditional IRA from the existing custodian to a new custodian before making the conversion. For example, American Estate & Trust ([www.IRACentral.com](http://www.IRACentral.com)) makes the conversion very easy and inexpensive. Once you have transferred your Traditional to American Estate & Trust, you then fill out a very short and simple conversion form. The form mostly consists of checking off some boxes to certify that you understand the rules which are supplied with the form. American Estate & Trust handles the account and conversion details from there and your IRA becomes a Roth about as soon as American Estate & Trust gets the form (there is a moderate fee for the conversion process). Then next January you will receive a 1099 from American Estate & Trust for the taxable amount of the conversion.

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**American Estate & Trust, LC**  
**[www.IRACentral.com](http://www.IRACentral.com)**