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Comparison between Traditional IRAs and Roth IRAs

Over the years, one of the most popular ways to save for retirement is to contribute to an Individual Retirement Account, or IRA. That's because IRAs enable you to invest (and hopefully grow) your money for retirement in a way that also brings significant tax advantages.

As you can imagine, much of my time as a financial advisor is spent answering questions on how people can get the most out of their IRAs. But the most common question I get is this:

What's best for me: a Traditional IRA, or a Roth IRA?

It's a smart question to ask, because while both types of IRAs help you save for retirement, they each come with different advantages and disadvantages. For that reason, you should weigh the pros and cons of each in order to decide which is more suitable for you.

But before we do that, let's quickly list what both Traditional and Roth IRAs have in common.

- Both are designed to help you save for retirement.
- Both usually come with a wide range of investment options.
- Both have the same annual contribution limits (the maximum amount you can contribute to your IRA each year).
- Both come with substantial tax advantages.

It's *when* these tax advantages apply that Traditional and Roth IRAs differ.

Here's how it works. With a Traditional IRA, all of the contributions you make are usually tax-deductible. For example, imagine you contributed $5,000 to an IRA in 2016. Typically, you would not have to pay taxes on that contribution. However, you will likely have to start paying taxes on your *distributions*, meaning the withdrawals you take out of your IRA once you're retired. These distributions are considered ordinary income and may be subject to income taxes.

With a Roth IRA, your contributions are *not* tax-deductible, but your distributions are. So in other words, the tax advantages of a Traditional IRA come *before* retirement, while the tax advantages of a Roth IRA come *after* retirement.

So how do you choose between the two? By following this simple rule of thumb:

If you expect your tax rate in retirement to be **lower than it is now**, go with a Traditional IRA. That way, you can skip paying taxes on your IRA while your tax rate is higher, and then pay *less* in taxes once your tax rate is lower. On the other hand, if you expect your tax rate to be **the same or higher during retirement**, a Roth IRA is likely a better choice.

For obvious reasons, you should consult with a tax professional to determine what your tax rate might be in retirement.

Of course, there are a few other differences between Traditional and Roth IRAs. Take a look at this handy table to learn what they are:

	Traditional IRA	**Roth IRA**
Contribution Age Limit	You can no longer make contributions on the year you reach age 70½.	No age limit to making contributions.
Income Limitations	Anyone can contribute to a Traditional IRA no matter how much income they make.	If your income exceeds a certain limit, you may not contribute to a Roth IRA.
Required Minimum Distributions	With a Traditional IRA, you *must* withdraw a minimum amount from your IRA every year following the year you reach age 70½. (Remember, these withdrawals may be subject to income tax.)	Roth IRA owners do not have to withdraw money from their accounts if they don't want to, even after retirement.
Deductibility	Contributions may be tax deductible, but distributions may be subject to income taxes.	Contributions are never tax deductible, but distributions are tax-free.

There are many other factors, details, and options to consider with both Traditional and Roth IRAs—far too many to cover in a single article. But at least now you understand some of the basics.

Contributing to Individual Retirement Accounts, whether Traditional or Roth, is an excellent way to save for retirement. As such, it's important that you take the time to determine which type of IRA is right for you. Hopefully this will give you a good place to start.