

A QUICK GUIDE TO THE ROTH IRA

JANUARY 2004

These rules of thumb represent my judgment about when it generally makes sense to choose the Roth IRA.

Roth IRA vs. Taxable Account

One of the alternatives to a Roth IRA is a regular taxable account with a bank, mutual fund or stockbroker. Either way you get no deduction when money goes in. The Roth IRA provides earnings that are tax-deferred and possibly tax-free. But if you make a taxable withdrawal of earnings from the Roth IRA, you'll report ordinary income (not long-term capital gain), and you may pay a 10% early distribution penalty.

- Choose the Roth IRA over a taxable account if you expect to qualify for tax-free distributions. Remember, you can withdraw *contributions* tax-free at any time, but *earnings* generally have to stay in until you're 59 1/2 and have satisfied the five-year requirement.
- If you expect to withdraw earnings when they're taxable, you're generally better off with a taxable account — especially if you're investing for long-term capital gains, or if the 10% early distribution penalty will apply.

Roth IRA vs. Nondeductible IRA

If you participate in a retirement plan maintained by your employer and your income is above certain levels, you may face a choice between saving in a Roth IRA or making a nondeductible contribution to a traditional IRA. In either case you get no deduction for your contribution, but the Roth IRA provides greater flexibility in withdrawing your contributions, and the possibility of withdrawing your earnings tax-free.

- Choose the Roth IRA over a nondeductible contribution to a traditional IRA in all cases.

Roth IRA vs. Deductible IRA

The choice between saving in a Roth IRA and a deductible contribution to a traditional IRA is more difficult. The traditional IRA gives you a deduction when you contribute, but the Roth IRA gives you a chance to have earnings that are entirely tax-free for decades to come. Here are the main ideas here:

- If you're saving the maximum amount each year, the Roth IRA is likely to be better.
- If you're in a low tax bracket when saving, the Roth IRA is likely to be better.

- Conversely, if you're in a high tax bracket when you contribute and expect to be in a much lower tax bracket when you withdraw your earnings, a traditional IRA may be the better choice.

Roth IRA vs. Employer Plan

If your employer provides a 401k or similar plan, you may face a choice between contributing to that plan or a Roth IRA. Don't forget you can do both!

- Choose your employer's 401k or similar plan if your employer will make matching contributions, and you don't expect to forfeit the matching contributions by quitting before they're vested.
- Otherwise choose as you would for a deductible IRA (see above).

Rules of Thumb for Conversions

Finally we come to the most complicated choice: whether to convert (roll over) your traditional IRA to a Roth IRA.

- Generally you shouldn't roll to a Roth IRA if you need to hold out some of the IRA money to pay taxes on the conversion and you'll pay the 10% early distribution penalty on the amount you hold out.
- If your retirement tax bracket will be 15%, avoid paying 25% or higher on your rollover. Remember that a *partial* rollover may permit you to avoid pushing into a higher tax bracket in the year of the rollover.
- If your traditional IRA contains mostly nondeductible contributions, rolling it to a Roth IRA should produce handsome benefits.
- Even if all contributions to your traditional IRA were deductible, rolling it to a Roth IRA may produce benefits if the first two points above don't apply.

Once again, these are merely rules of thumb. In most cases they give the right results, but your particular situation may call for something a bit different. We cannot stress enough the importance of getting your entire financial plan done first. If you have any questions do not hesitate to contact us at (800) 447-0579 with any questions.