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The Savvy Investor

Roth IRA – A Great Plan?

The beginning of the year is a good time to contribute to a Roth IRA and to open one if you haven't taken advantage of this tax-free investment vehicle.

Eligibility

Married: Your Adjusted Gross Income must be under $183,000.

Single: Your AGI must be under $116,000.

Actually, the AGI can be slightly higher, but the amount you can contribute is reduced.

Contributions to a 401(k) do not affect the eligibility requirement. You can contribute to both.

You can be of any age, as long as you have earned income.

How Much Can I Contribute?

You can contribute up to $5,500 if you under age 50 and $6,500 if age 50 or older. You must have earned income up to at least the amount you contribute.

You can have a Roth IRA for your spouse who does not have any earned income, as long as you have earned income.

Why Have a Roth IRA?

All money in the Roth IRA grows TAX FREE. You don't pay any taxes on money (or growth of this money) in the Roth IRA.

In addition, you pay ZERO taxes when you withdraw the money (provided it is withdrawn after age 59.5 and the account has been open for five years or longer).

Contrast this to a regular IRA or a 401(k) plan, where the money grows only tax deferred, not tax free. When it is withdrawn from a regular IRA, you pay taxes on every penny withdrawn at your ordinary (high) income tax rate.

How About Withdrawals?

Money must be left in the Roth for five years from the beginning of the year the account was established and until age 59.5 (which ever is later). This is similar to a regular IRA.

However, unlike a traditional IRA, you do not have to start withdrawing money at age 70.5. In fact, you never have to withdraw the money.

There are several exceptions that allow you to withdraw the money early: disability, death, or a first-time home purchase. The first two exceptions are bummers.

The Roth is not a good vehicle for saving for college education since early withdrawals are taxed as ordinary income and you lose the tax-free advantage of the Roth.

What are the Drawbacks?

It doesn’t get much better. The money grows TAX FREE and there are no mandatory withdrawals starting at age 70.5. If you do make withdrawals, you do not pay taxes on the withdrawals, unlike a Regular IRA.

Bottom Line

Regardless of your age, put money into a Roth IRA if you qualify. Do the same for your spouse, even if she has no earned income, provided you do.

Contact us for more information.