

TRADITIONAL OR ROTH???

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YOU DECIDE



The focus on retirement savings and investment has intensified in recent years. What was once a good idea in the eyes of financial planners is now essential to the future of those planning for retirement.

Legislators responded to the impending needs of “Baby Boomers” through pension reform with passage of the Economic Growth & Tax Relief Reconciliation Act (EGTRRA) of 2001. More recently, however, the Pension Protection Act (PPA) of 2006 made permanent some of the ephemeral provisions of EGTRRA, while enacting additional changes.

While the main focus of both EGTRRA and PPA was Defined Benefit and Defined Contribution Plans, IRAs and Roth IRAs were significantly affected.

Traditional IRA or Roth IRA: How will I know which to choose?

This can still be a confusing decision and merits careful thought. First, gather some information about you and your spouse:

- ✓ employment status
- ✓ active participation in Employer plans
- ✓ Modified Adjusted Gross Income (MAGI)¹

Next, take a moment to review some of the properties of the different IRAs. Let’s start with a look at the new limits:

Traditional & Roth IRA Contribution Limits

The contribution limit has more than doubled in five years, and many taxpayers are not even aware of that fact. In addition, individuals who have attained age 50 can play catch-up and add even more to their IRA each year.

	Contribution	Catch-Up
2006	\$4,000	\$1,000
2007	\$4,000	\$1,000
2008	\$5,000	\$1,000

¹ MAGI defined in IRS Publication 590

The descriptions provided above are intended to provide background information about IRAs, and are not a complete review of all the legal and tax laws pertinent to these plans. Clients must consult with their legal and/or tax advisors for answers to all technical and tax law-related questions.

TRADITIONAL IRA

Whether deductible or not, the Traditional IRA has many advantages, including tax deferred savings and retirement security. So even if your employer funds a retirement plan for you, it’s good to know you have a supplemental plan in reserve for a rainy day.

All that is true, but can I deduct the contribution?

To refute a popular myth, **every wage earner (under the age of 70 ½) has the opportunity to fund an IRA**. But, not every wage earner can deduct the contribution from income.

Establishing deductibility is a two-tier process:

- I. First, determine if you or your spouse are “active participants” (see your W-2) in a tax qualified employer plan, including for example a 401(k), 403(b), Profit Sharing, SEP or SIMPLE.
- II. If no, both you and your spouse can fully deduct your IRA contribution, regardless of income. If yes, consult the chart below for Modified Adjusted Gross Income (MAGI) thresholds:

	JT Return (MAGI)	Single Return² (MAGI)
2006	\$75,000 - \$85,000	\$50,000 - \$60,000
2007	\$83,000 - \$103,000	\$52,000 - \$62,000

If your MAGI falls below the threshold amount, you can fully deduct your IRA contribution, and if above, no deduction is allowed.

A special exception applies to married couples with one non-working or non-participating spouse. The MAGI threshold remains the same as previously stated for the active participant, but for the non-active spouse becomes:

2006	\$150,000 - \$160,000
2007	\$156,000 - \$166,000

² Married taxpayers filing separate returns are subject to a threshold of \$0-\$10,000.

Joint filers in this situation may be able to deduct the contribution for the spouse even though they cannot deduct the contribution for the active participant. This year is the first time this limit has been indexed.

Increased Rollover Flexibility

There is now more freedom to rollover funds between Traditional IRAs and qualified plans than ever before.

Most IRA funds (except non-deductible contributions) can be rolled over to employer plans, and most employer plans – even some 457s – can now rollover into IRAs. Keep in mind that the employer plan documents must allow for these transactions, so check with the appropriate benefits department for details.

ROTH IRA

As an alternative to the non-deductible IRA, the Roth IRA is an excellent way for working individuals and their spouses to build substantial retirement savings in a regular, disciplined way.

Contributions are always non-deductible, earnings and “**qualified**” distributions are tax-free.

Besides having earned income, or being the spouse of a wage earner, MAGI must be within specific threshold limits to qualify you to contribute to a Roth:

	JT Return (MAGI)	Single Return³ (MAGI)
2006	\$150,000- \$160,000	\$95,000 - \$110,000
2007	\$156,000- \$166,000	\$99,000 - \$114,000

A partial Roth contribution is permitted when MAGI falls between these ranges.

Unlike Traditional IRAs, **there is no age limit on eligibility to fund a Roth**, and no distribution requirement upon attainment of age 70 ½. Also, active participation in an Employer plan does not factor into the Roth equation.

Tax-Free Distributions

That’s the draw: to ultimately take distributions tax-free. However, there are two conditions to meet for a “**qualified**” distribution:

- The first deposit must be 5 years old
- You must have one of four qualifying reasons:

³ Married taxpayers filing separate returns are subject to a threshold of \$0-\$10,000.

1. attainment of age 59 ½
2. death
3. disability
4. first-time homebuyer

Contributions and converted amounts (after 5 years if converted pre-age-59 ½) can always be removed without tax or penalty. However, unless a qualifying reason applies, the earnings may be taxed and subject to penalty unless otherwise exempted.

Should I Convert from a Traditional IRA to a Roth?

Your MAGI – married or single – cannot exceed \$100,000 to be eligible to convert your Traditional IRA assets to a Roth. The entire taxable portion of your IRA will be added to ordinary income for the year in which you convert.

Why convert? Many people will need a more lengthy consultation to project the possible benefit. Some considerations are that you must have the funds outside of the IRA to pay the additional tax, and that you anticipate being in a higher tax bracket than you are today upon drawing on the funds.

Now that you have the facts...

It can be daunting, but you can be certain of one thing – there is an IRA for everyone! And with value added self-direction, you’re in control.

A “rule of thumb” you may wish to consider:

- If you are in a position to deduct your IRA contribution and wish to do so, fund a Traditional deductible IRA.
- If you cannot deduct and fall within the income range to qualify for a Roth, fund a Roth.
- If you are not eligible to deduct an IRA contribution or fund a Roth, don’t miss the opportunity to put the maximum amount in a Traditional non-deductible IRA.

Whatever your situation or income status, don’t miss the opportunity to begin saving for retirement. All working Americans and their spouses can take advantage of a disciplined approach to building substantial savings for retirement through either a Traditional IRA or a Roth IRA.

Call on your Janney Financial Consultant who, together with your tax advisor, can answer all of your retirement plan questions and guide you to a dynamic savings plan.