Which IRA is Right for Me?

Individual Retirement Accounts (IRAs) are recognized as one of the most attractive retirement savings vehicles available to investors. IRAs allow investors to save and grow money in a tax-advantaged account. Utilizing a retirement savings vehicle like this can greatly enhance your long-term financial prosperity, but deciding which type of IRA is right for your investment goals can be a challenge. Here are answers to common questions around this important topic.

1. What types of IRAs should I consider?

At its most basic level, there are two types of IRAs – traditional and Roth IRAs. The biggest difference between the two is the tax treatment of contributions and distributions. Contributions are the process by which an investor puts money into an account and a distribution is the process of taking that money out.

2. How does a traditional IRA work?

Contributions

With a traditional IRA, you either make after-tax contributions or (if you qualify and choose to do so), tax-deductible contributions. If you are not covered by a retirement plan at work, your contributions can be fully deducted from income tax. If you or your spouse are covered by a plan, income limits apply. To claim a full deduction on 2024 taxes, a single person can't earn more than $77,000 and a married person filing a joint return can't earn more than $123,000.

Distributions

Money held in a traditional IRA grows on a tax-deferred basis, a characteristic that allows your money to grow faster. However, when withdrawals are taken, all earnings are subject to tax at your applicable ordinary income tax rate in the year of the withdrawal. If you claimed a tax deduction at the time you made contributions to your IRA, those too are subject to tax. With some exceptions, withdrawals before age 59-1/2 also may incur an early distribution penalty. One important note is that traditional IRAs are subject to required minimum distribution (RMD) rules which define the age at which an investor must begin to take money out of the account. Under current law, distributions must begin by April 1 in the year after reaching age 73 and continue every year thereafter.

3. How does a Roth IRA work?

Contributions

All Roth IRA contributions are made with after-tax dollars that grow tax-free until you start making withdrawals. However, income limits apply that determine whether you qualify to make full Roth IRA contributions. In 2024, the ability for single individuals to make full Roth IRA contributions is phased out if income is higher than $146,000. For married couples filing a joint return, you cannot make a full Roth IRA contribution if gross income is more than $230,000.

Distributions

If a five-year holding period requirement is met, all distributions (contributions and earnings) after age 59-1/2 are eligible for tax-free treatment. In addition, RMD rules do not apply to Roth IRAs.

4. How much can I contribute to IRAs?

In 2024, you can contribute up to $7,000 ($8,000 for those age 50 and older) or up to 100% of earned income, whichever is less. This is the maximum contribution amount for both traditional and Roth IRAs for the year.

Note that contributions can't exceed 100% of your earned income if you earn less than the limits stated above. Also, these limits apply to total IRA contributions for the year. This is applicable even if you hold multiple IRAs or make contributions to both Roth IRAs and traditional IRAs.

5. Which IRA is right for me?

The answer is different for everybody. Determining how much to set aside for retirement and in what types of savings vehicles is best determined through careful planning. A financial professional can help you understand which account is best suited to meet your long-term financial goals.

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