

The Roth IRA

By Steve Gilbertson

For many years, the Traditional IRA was the individual retirement plan of choice among investors. Allowing for both tax-deductible contributions and tax-deferred growth, it was the logical individual account for building a retirement nest egg. However, in the late 1990's, the Roth IRA was introduced and became a viable alternative with many advantages over the Traditional IRA. These advantages merit it worthy of consideration for your retirement dollars going forward.

While all contributions into the Roth IRA are after-tax (not tax-deductible) contributions, the primary advantage of the Roth IRA is that earnings on investments within the account are tax-free. Therefore, when you take a distribution of assets, assuming you are at least 59 ½ and the money has been in the account for at least five years, you pay no taxes on the distribution. That's right – the entire distribution is tax-free! This is in stark contrast to the traditional IRA, which has only tax-deferred (not tax-free) growth on earnings. With the traditional IRA, the full distribution is taxed as ordinary income. If you experience substantial growth within the account, this difference can be extremely significant. Other advantages of the Roth IRA over the Traditional IRA include no Required Minimum Distributions and no age limitation on contributions.

For 2004, the maximum contribution into the Roth IRA is \$3,000 (with a catch-up provision of \$500 for individuals age 50 and older). The maximum contribution increases to \$4,000 in 2005 and to \$5,000 in 2008 (contribution limits for the Roth and Traditional IRA are exactly the same.) There are income limitations for Roth contributions – If Adjusted Gross Income (AGI) reaches \$95,000/single or \$150,000/joint, contribution limits are reduced. If AGI is over \$110,000/single or \$160,000/joint, no Roth IRA contributions are allowed for that calendar year.

Like the traditional IRA, there are generally penalties for early withdrawal from the account before age 59 ½. However, unlike the Traditional IRA, withdrawals of contributions are not taxed and are penalty-free. Remember, you have already paid taxes on this money, as contributions into a Roth are made with after-tax dollars. Earnings withdrawn before 59 ½ are penalized unless an exception is satisfied. Legitimate exceptions include post-secondary school expenses, health insurance after lengthy unemployment, and distribution through fixed periodic payments.

If you already have a Traditional IRA, it is possible to convert the Traditional IRA to a Roth IRA. Upon conversion, you will be taxed on the full amount as ordinary income. However, once it becomes a Roth IRA, the earnings will grow tax-free and distributions will not be taxed. This may make sense for you, depending on your personal situation regarding factors such as your current and future tax bracket as well as your investing time horizon. While it is not appropriate for everyone, it is certainly an option worth considering.

If you think a Roth IRA may be right for you or to find out more about this topic, please contact Steve Gilbertson at sgilbertson@bryton.com, 515.223.1601.

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