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It's Time To Re-Think Roth

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About The Author:
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If you thought a Roth IRA was out of the picture for you, think again.

Perhaps you associated Roth IRAs with younger investors who had overall lower incomes and longer savings horizons. Things have changed.

When Roth IRAs were first established in 1997, income limits prevented higher income individuals from using this tax-free (rather than tax-deferred) income-producing savings program. Later, the IRS permitted Roths to be offered inside a 401(k) plan and removed the income barrier. Many higher income individuals, however, retained the misperception that it was "too late to get on the Roth road."

If this sounds like you, give Roth another look.

Roth Contributions Are Made After Tax

First, let's set the ground rules of Roth: Whether in an IRA or 401(k) plan, Roth contributions are made "after-tax." Therefore, you count this contribution as income on your taxes and pay the tax on it in the year it's earned. For high earners, the fact that the tax deduction that accompanies a 401(k) contribution is gone is sometimes the end of the story. But it shouldn't be:

- While all the earnings on both types of accounts compound without tax, earnings in the traditional 401(k) account are fully taxable on distribution
- Roth earnings are never taxed (if held in a Roth IRA that is at least 5 years old)
- Roth is also not subject to the minimum distribution rules at age 70 ½

Tax Rates Will Likely Rise

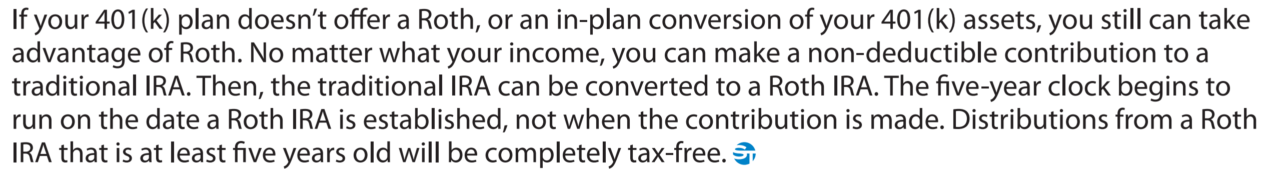
If most of your retirement savings is in qualified plans, it's likely to be fully taxable as you take it out in retirement. Relying on those distributions to maintain your lifestyle may mean taking much more each year than you really want because of the tax bite. Consider these facts:

- With the likelihood of rising tax rates, paying the tax on a $20,000 contribution now to avoid the tax on a $50,000 distribution in the future may be very prudent
- Combining withdrawals from both taxable and nontaxable accounts may keep your effective tax rate down significantly
- With a Roth, there are no forced withdrawals, so you can take out whatever is best for you, or take none at all and leave it all to your children

How To Take Advantage Of A Roth

If you haven't taken advantage of the Roth feature in your 401(k) plan, you may be able to convert a portion of your pre-tax account to a Roth through in-plan conversion. If the plan permits, there is still much to consider in making the decision.

High earners will have to pay tax on the converted amount which, added to their wages, might put them into a detrimental tax position, such as having to pay the 3.8 percent Medicare tax on earnings over $250,000. Also, if you cannot pay the tax with money other than the conversion, much of the value would be lost, not to mention the 10 percent penalty for a premature distribution before age 59 ½.



If your 401(k) plan doesn’t offer a Roth, or an in-plan conversion of your 401(k) assets, you still can take advantage of Roth. No matter what your income, you can make a non-deductible contribution to a traditional IRA. Then, the traditional IRA can be converted to a Roth IRA. The five-year clock begins to run on the date a Roth IRA is established, not when the contribution is made. Distributions from a Roth IRA that is at least five years old will be completely tax-free.

If you have questions about Roth IRAs or any other retirement plan or program, please contact Claudia Allen at cgallen@strausstroy.com or 513-629-9462.

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