Should You Contribute to a Traditional IRA or a Roth IRA?

Your age and income level may help you decide which savings plan is the best fit.

By Teresa Mears | Contributor May 19, 2016, at 11:50 a.m.

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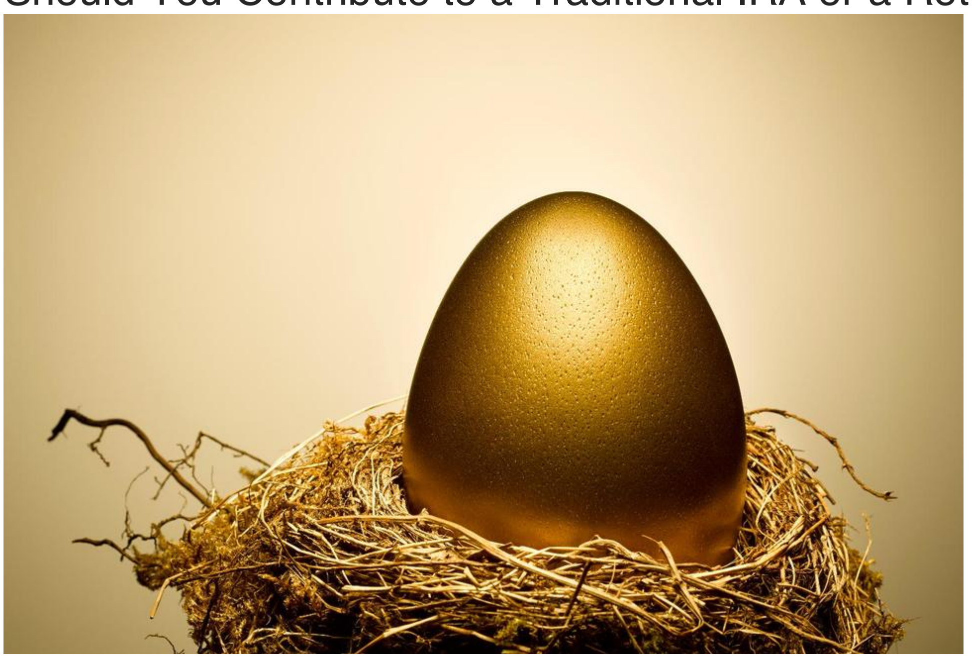

Start saving now so you'll have a significant nest egg once you're ready to leave the workforce. (GETTY IMAGES)

We all know that we should be saving more money for retirement. But sometimes the options can be confusing. For example, is it better to put money in a Roth IRA or a traditional IRA?

While the answer, of course, is that any retirement savings plan is better than none at all, there are times when one option is the better course. Whether a Roth or a traditional IRA is the best choice for you this year depends on your circumstances.

"There's no straight plain vanilla answer," says Dan Yu, managing principal of EisnerAmper Wealth Advisors in New York. "Nobody says you can't split it in half."

Making the right decision includes making a prediction: Will your tax rate be lower in retirement? If so, you might want to invest in a traditional IRA and take a tax deduction now. If you're in a low tax bracket now, you might want to pay taxes now and amass funds in a Roth that you can withdraw tax-free later.

But not everyone has the same choices. If your income is too high, you can't contribute to a Roth IRA. If you have a retirement plan at work, there are income limits to how much you can deduct of your regular IRA contributions. Either way, your contribution is limited to $5,500 a year, or $6,500 if you're over 50.

To contribute to a Roth IRA, your modified adjusted gross income can't be more than $132,000 in 2016, and if you earn more $117,000, you can contribute only a reduced amount. Those numbers apply to single filers, heads of households or married people filing separately. The limits for a married couple filing jointly are $184,000 for a full contribution and $194,000 for a limited contribution. Contributions come from after-tax income and can be withdrawn tax-free, including earnings, in retirement. You can withdraw the amount you contributed at any time without paying a penalty.

You can contribute to a traditional IRA regardless of income. If neither you nor your spouse is covered by a retirement plan at work, then your full contribution is tax-deductible. If only your spouse is covered and you file jointly, you can get a full deduction as long as your modified gross income is less than $184,000 and a lesser deduction with an income up to $194,000.

If you are covered by a retirement plan at work, you can get a full deduction only if your modified gross income is $61,000 or less (single) or $98,000 (married filing jointly). You can get partial deductions if your income is up to $71,000 (single) and $118,000 (married filing jointly). Withdrawals are taxed when you take out the money, and if you withdraw anything before you reach age 59 1/2, you will pay a 10 percent penalty.

"This isn't just an investment decision. It's a tax decision," says William Meyer, CEO of RetireeIncome.com, based in Leawood, Kansas, a suburb of Kansas City, Missouri. "If you're not comfortable running tax calculations, you need to find an advisor who can do both tax and wealth management."

Having a variety of retirement savings vehicles – a regular IRA, a Roth IRA and savings outside IRAs – provides the maximum flexibility for minimizing the tax burden in retirement, he says.

"The order in which you tap these individual accounts has a huge impact on how long your money will last," Meyer says. The right decision each year is going depend on your age, what retirement savings you already have, your current tax bracket and what you expect your financial picture to be in retirement. The decision may also be part of your estate planning, because while you are required to start withdrawing from a regular IRA at age 70 1/2, you are never required to take any money out of a Roth. Plus, you can continue contributing to a Roth after age 70 1/2 as long as you have earned income.

"If they're five to 10 years away from retirement, we can work with them to have a more reliable estimate of what their tax bracket will be in retirement," says Tony D'Amico, CEO of the Fidato Group in suburban Cleveland. "For me, in doing financial planning, it's a numbers issue."

A Roth IRA or 401(k) is a particularly good choice for young people just starting out in the workforce, whose lower salaries mean they wouldn't get much of a tax deduction from a traditional IRA. "If you're young, you're in a low tax bracket … you are the perfect candidate for a Roth," says Mari Adam, a financial advisor in Boca Raton, Florida. "It's going to compound forever."

Unlike with a traditional IRA, if you need the money at any time – for a house, a child's college education, graduate school – you can pull out the contributions you made with no penalty. "If you put it in as a contribution, you can take it out the next day," Adam says. "Grab that opportunity when you can. One day, you're going to be making too much money." Even if your workplace doesn't offer a 401(k) or Roth 401(k) option, it's important to start saving, Adam says. You can easily do it through Vanguard, Fidelity, your bank or a similar institution.

"Otherwise, you're going to wake up in 20 years and you're hugely behind," Adam says. "Please start young, even if you put in small amounts every year. … People tend not to save because it's so complicated. That's just sad."

Here are four factors to take into account when deciding whether to invest your retirement funds in a Roth IRA or traditional IRA:

How does your income now compare with what you expect in retirement? If your income is low now, a Roth might be a good choice, especially if you expect to earn more later. If you earn too much for a Roth, a traditional IRA is your only option. If you're in between, do your personal math, comparing the taxes you'll pay if you don't make a deductible contribution with the tax you'll expect to pay later.

What retirement savings do you already have? Having a diversity of investments in your portfolio makes it easier to minimize taxes and extend the life of your savings. Take into account whether a Roth or traditional IRA will better add to your retirement portfolio.

How close are you to retirement? The closer you are, the better picture you may have of your future and whether you'll need tax-free withdrawals.

Do you expect your money to outlive you? Once you reach age 70 1/2, you must take withdrawals from a traditional IRA and pay taxes on those withdrawals, but this is not the case with a Roth IRA. If you don't need those withdrawals, you're better off with a Roth. If you expect to need them, and you have a higher income now, you may be better off contributing to a regular IRA.