FEATURING KEVIN HAGERTY

TRADITIONAL IRA, ROTH IRA, 401(k), 403(b): WHAT'S THE DIFFERENCE?

- Traditional IRA vs. Roth IRA
- Employer Related Plans - 401(k) & 403(b)

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INTRODUCTION

The earlier you begin planning for retirement, the better off you will be. However, the problem is that most people don't know how to get started or which plan is the best vehicle to get you there.

A good retirement plan usually involves more than one type of investment account for your retirement funds. This may include both an IRA and a 401(k), allowing you to maximize your planning efforts.

If you haven't begun saving for retirement yet, don't be discouraged. Whether you begin through an employer sponsored plan like a 401(k) or 403(b) or you begin a Traditional or Roth IRA that will allow you to grow earnings from investments through tax deferral, it is never too late or too early to begin planning.

This article discusses the four main retirement savings accounts, the differences between them and how Saxon can help you grow your nest egg.

"A major trend we see is that if people don't have an advisor to meet with, they tend to invest too conservatively, because they are afraid of making a mistake," said Kevin Hagerty, a Financial Advisor at Saxon Financial.

"Then the problem is they don't revisit it, and if you're not taking on enough risk you're not giving yourself enough opportunity for growth. You run the risk that your nest egg might not grow to what it should be."

"Saxon is here to help people make the best decision on how to invest based upon their risk tolerance. We have methods to determine an individual's risk factors, whether it be conservative, moderate or aggressive, and we make sure to revisit these things on an ongoing basis."

Traditional IRA vs. Roth IRA

Who offers the plans?

Both Traditional and Roth IRAs are offered through credit unions, banks, brokerage and mutual fund companies. These plans offer endless options to invest, including individual stock, mutual funds, etc.

Eligibility

Anyone with Earned, W-2 Income from an employer can contribute to Traditional or Roth IRAs, as long as you do not exceed the maximum contribution limits. However, only qualified distributions from a Roth IRA are tax-free.

In order to be able to contribute to a Roth IRA, you must have taxable income and your modified adjusted gross income is either:

- less than $194,000 if you are married filing jointly
- less than $122,00 if you are single or head of household
- less than $10,000 if you're married filing separately and you lived with your spouse at any time during the previous year.

Tax Treatment

With a Traditional IRA, typically contributions are fully tax-deductible and grow tax deferred. So when you take the money out at retirement, it is taxable. With a Roth IRA, the contributions are not tax deductible but grow tax deferred. So when the money is taken out at retirement, it will be tax free.

"The trouble is nobody knows where tax brackets are going to be down the road in retirement. Nobody can predict with any kind of certainty because they change," explained Kevin. "That's why I'm a big fan of a Roth."

A Roth IRA can be a win-win situation from a tax standpoint. Whether the tax brackets are high or low when you retire, it doesn't matter. Your money will be tax free when you withdraw it. Another advantage is, at 70 ½, you are not required to start taking money out. "We've seen Roth IRAs used as an Estate planning tool, and they'll be able to take that money out tax free. It's an immense gift," Kevin said.

Maximum Contribution Limits

Contribution limits between the Traditional and Roth IRAs are the same; the maximum contribution is $6,000, or $7,000 for participants 50 and older.However, if your earned income is less than $6,000 in a year, say $4,000, that is all you would be eligible to contribute.

"People always tell me, 'Wow, $6,000, I wish I could do that. I can only do $2,000.' Great, do $2,000," said Kevin. "I always tell people to do what they can and then keep revisiting it and contributing more when you can. If you increase a little each year, you will be contributing $6,000 eventually and not even notice."

Withdrawal Rules

With a Traditional IRA, withdrawals can begin at age 59 ½ without a 10% early withdrawal penalty but still with Federal and State taxes. The IRS will mandate that you begin withdrawing at age 70 ½.

Even though most withdrawals are scheduled for after the age of 59 ½, a Roth IRA has no required minimum distribution age and will allow you to withdraw contributions at any time. For example, if you have contributed $15,000 to a Roth IRA, but the actual value of it is $20,000 due to growth, then the contributed $15,000 could be withdrawn with no penalty, any time - even before age 59 ½.

Employer Related Plans - 401(k) & 403(b)

A 401(k) and a 403(b) are theoretically the same thing; they share a lot of similar characteristics with a Traditional IRA as well.

Typically, with these plans, employers match employee contributions, such as .50 on the dollar up to 6%. The key to this is to make sure you are contributing anything you can to receive a full employer match.

Who offers the plans?

One of the key differences with these two plans lies in whether the employer is a for-profit or non-profit entity.

These plans will have a number of options of where to invest, often a collection of investment options selected by the employer.

Eligibility

401(k)'s and 403(b)'s are open to all employees of the company for as long as they are employed there. If an employee leaves the company they are no longer eligible for these plans since 401(k) or 403(b) contributions can only be made through pay roll deductions. However, you can roll it over into an IRA and then continue to contribute on your own.

Only if you take possession of these funds would you pay taxes on them. If you have a check sent to you and deposit it into your checking account – you don't want to do that.

Then they take out federal and state taxes and tack on a 10% early withdrawal penalty if you are not age 59 ½. It can be beneficial to roll a 401(k) or 403(b) left behind at a previous employer over to an IRA so it is in your control, and you have increased investment options.

Tax Treatment

Contributions are made into your account on a pretax basis through payroll deduction.

Maximum Contribution Limits

The maximum contribution is $19,500, or $26,000 for participants 50 and older.

Depending on the employer, some 401(k) and 403(b) plans provide loan privileges, providing the employee the ability to borrow money from the employer without being penalized.

Withdrawal Rules

In most instances, comparable to a Traditional IRA, withdrawals can begin at age 59 ½ without a 10% early withdrawal penalty. The IRS will mandate that you begin withdrawing at age 70 ½. Contributions and earnings from these accounts will be taxable as ordinary income. There are certain circumstances when one can have penalty free withdrawals at age 55, check with your financial or tax advisor.

In Conclusion...

"It is important to make sure you are contributing to any employer sponsored plan available to you, so you are receiving the full employer match. If you have extra money in your budget and are looking to save additional money towards retirement, that's where I would look at beginning a Roth IRA. Then you can say you are deriving the benefits of both plans - contributing some money on a pretax basis, lowering federal and state taxes right now, getting the full employer contribution match and then saving some money additionally in a Roth that can provide tax free funds/distributions down the road," finished Kevin.

To learn more, contact Kevin Hagerty today at (513) 333-3886 or via email at khagerty@gosaxon.com.