

WHAT'S THE RIGHT OPTION? TRADITIONAL OR ROTH RETIREMENT



TOPSAILTM
WEALTH MANAGEMENT

Traditional or Roth?

- Contributing annually to a traditional IRA or 401(k) on a pre-tax basis helps reduce your tax bill in the years you contribute.
- One downside is that all withdrawals will be a taxable event and once you reach a required minimum distribution age, you'll be forced to take distributions.
- A Roth IRA is funded with after-tax dollars and if plan provisions are met withdrawals are tax-free.

Pay taxes now or later?

Will your taxes be lower in retirement, if so, a traditional IRA may be the better option—but you should still consider the full picture. You could be wrong and even if you're right, your tax savings may not outweigh the other advantages of the Roth (see below).

Roth IRA

With a Roth IRA, contributions are not tax-deductible, but earnings can grow tax-free, and qualified withdrawals are tax- and penalty-free. Roth IRA withdrawal and penalty rules vary depending on your age and how long you've had the account and other factors. Before making a Roth IRA withdrawal, keep in mind the following guidelines, to avoid a potential 10% early withdrawal penalty:

- Withdrawals must be taken after age 59½.
- Withdrawals must be taken after a five-year holding period.
- There are exceptions to the early withdrawal penalty, such as a first-time home purchase, college expenses, and birth or adoption expenses.

Lessen the tax burden on your heirs

Non-spouse beneficiaries who inherit your Roth IRA may have to take RMDs, with few exceptions, but not for 10 years, and they won't have to pay any federal income tax on their withdrawals if the account's been open for at least five years. Allowing Roth owners to pass potentially significant assets to their heirs essentially tax-free.

Conversion

If you decide a Roth IRA is right for you, you can contribute up to the maximum each year, and you can also convert all or part of your traditional IRA to a Roth account, regardless of your income, with no annual limit. You pay ordinary income tax on all the previously untaxed conversion amount in the year you make it. The further you are from retirement, the more likely you are to recoup the value of the tax paid at conversion. But the calculation can be complex. Investment selection is important, and the allocation will determine the growth. Topsail's can provide a break-even analysis and we'll coordinate with your tax professional.

Gain flexibility

Roth IRAs allow withdrawals of contributions at any time without penalty. However, because the withdrawals of earnings before age 59½ are treated as taxable income, you may wind up with a tax emergency on top of the initial crisis. Explore other options first.

Comparing Traditional and Roth IRAs

Rules	Roth IRA	Traditional IRA
2022 Contribution Limits	\$6,000; \$7,000, if age 50 or older	\$6,000; \$7,000, if age 50 or older
2023 Contribution Limits	\$6,500; \$7,500 if age 50 or older.	\$6,500; \$7,500 if age 50 or older.
2022 Income Limits	Single tax filers with MAGIs of less than \$144,000 (phaseout begins at \$129,000) and married couples filing jointly with MAGIs of less than \$214,000 (phaseout begins at \$204,000) are eligible.	Anyone with earned income can contribute, but tax deductibility is based on income limits and participation in an employer plan.
2023 Income Limits	Single tax filers with MAGIs of less than \$153,000 (phaseout begins at \$138,000) and married couples filing jointly with MAGIs of less than \$228,000 (phaseout begins at \$218,000) are eligible.	Anyone with earned income can contribute, but tax deductibility is based on income limits and participation in an employer plan.
Age Limits	No age limitations on contributions.	No age limits on contributions.
Tax Credit	Available for "saver's tax credit."	Available for "saver's tax credit."
Tax Treatment	No tax deductions for contributions; tax-free earnings and withdrawals in retirement.	Tax deduction in contribution year; ordinary income taxes owed on withdrawals.
Withdrawal Rules	Contributions can be withdrawn at any time during the tax year, tax-free and penalty-free. Five years after your first contribution and age 59½, earnings withdrawals are tax-free, too.	Withdrawals are penalty-free beginning at age 59½.
Required Minimum Distribution	None for the account owner. Account beneficiaries are subject to the RMD rules.	Distributions must begin at age 73 for account owners born between 1951 and 1959 and 75 for those born in 1960 or later. Beneficiaries are also subject to the RMD rules.
Extra Benefits	After five years, up to \$10,000 of earnings can be withdrawn penalty-free to cover first-time homebuyer expenses. Qualified education and hardship withdrawals may be available without penalty before the age limit and five-year waiting period.	Up to \$10,000 penalty-free withdrawals to cover first-time homebuyer expenses. Qualified education and hardship withdrawals are also available.

Please note that tax expectations relate to the overall federal tax landscape as well as your personal tax rate. You should consider your future marginal tax rate, not future income, when thinking about Roth conversions. Because tax brackets may be wide and filing status may change, changes in future income may or may not affect your future marginal tax rate.

This discussion concerns only the federal tax consequences of the strategies described. State laws vary widely and may differ from federal tax laws. Tax discussions are based on current rules and regulations in effect as of the publication date and are subject to change at any time. Investors should consult with their tax advisor before engaging in any transaction that may have tax consequences.

All investing is subject to risk, including the possible loss of the money you invest. We recommend that you consult a tax or financial advisor about your individual situation.

Withdrawals from a Roth IRA are tax free if you are over age 59½ and have held the account for at least five years; withdrawals taken prior to age 59½ or five years may be subject to ordinary income tax or a 10% federal penalty tax, or both. (A separate five-year period applies for each conversion and begins on the first day of the year in which the conversion contribution is made).

Topsail Wealth Management does not provide specific tax or legal advice.

Topsail Wealth Management is a marketing name for Independent Advisor Alliance, LLC. All investment advice is offered through Independent Advisor Alliance, LLC, a registered investment adviser.

© 2023 Topsail Wealth Management