# Question: Traditional IRA vs. Roth IRA - Which is Better?

**Answer:** Deciding whether to open a Roth IRA or Traditional IRA is a major decision with potentially large financial consequences. Both forms of the IRA are great ways to save for retirement, although each offers different advantages.

## Traditional IRA Profile

- Tax deductible contributions (depending on income level)
- Withdraws begin at age 59 1/2 and are mandatory by 70 1/2.
- Taxes are paid on earnings when withdrawn from the IRA
- Funds can be used to purchase a variety of investments (stocks, bonds, certificates of deposits, etc.)
- Available to everyone; no income restrictions
- All funds withdrawn (including principal contributions) before 59 1/2 are subject to a 10% penalty (subject to exception).

## Roth IRA Profile

- Contributions are not tax deductible
- No Mandatory Distribution Age
- All earnings and principal are 100% tax free if rules and regulations are followed
- Funds can be used to purchase a variety of investments (stocks, bonds, certificates of deposits, etc.)
- Available only to single-filers making up to $95,000 or married couples making a combined maximum of $150,000 annually (Check with IRS for current year limits)
- Principal contributions can be withdrawn any time without penalty (subject to some minimal conditions).

## Tax Deferred vs. Tax Free

The biggest difference between the Traditional and Roth IRA is the way the U.S. Government treats the taxes. If you earn $50,000 a year and put $2,000 in a traditional IRA, you will be able to deduct the contribution from your income taxes (meaning you will only have to pay tax on $48,000 in income to the IRS). At 59 1/2, you may begin withdrawing funds but will be forced to pay taxes on all of the capital gains, interest, dividends, etc., that were earned over the past years.

On the other hand, if you put the same $2,000 in a Roth IRA, you would not receive the income tax deduction. If you needed the money in the account, you could withdraw the principal at any time (although you will pay penalties if you withdraw any of the earnings your money has made). When you reached retirement age, you would be able to withdraw all of the money 100% tax free. The Roth IRA is going to make more sense in most situations. Unfortunately, not everyone qualifies for a Roth. A person filing their taxes as single can not make over $95,000. Married couples are better off, with a maximum income of $150,000 yearly. (Check with IRS for current year limits)

## Is there any way to avoid the 10% early withdrawal penalty on my IRA?

Yes! There are ways to avoid paying early withdrawal fees. Here are the eight allowable reasons:

1. Permanent disability of IRA owner

2. Death of IRA owner

3. Withdrawals are used to pay for unreimbursed medical expenses

4. Withdrawals are used to purchase first home

5. Higher education costs

6. Money is used to pay back taxes to the IRS after a levy has been placed against the IRA

7. Withdrawals used to pay medical insurance premiums

8. Withdrawal made on or after the day the IRA owner turns 59 1/2

## Where can I open an IRA?

IRA's of both types can be opened at Sonoma Federal Credit Union. If you are interested in holding stocks or bonds in your IRA, you will need to see our Financial Planner.

## How much money do I need to open an IRA?

You can open an IRA with Sonoma Federal Credit Union for $5.

## We also offer SEP IRAs for our self-employed members.