BRANNAM WEALTH MANAGEMENT of RAYMOND JAMES®

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Why Invest in a Roth IRA?

What is a Roth IRA? By definition it is an individual retirement account that grows tax-deferred and is generally not taxed upon distribution. While your contributions to a Roth IRA are after-tax contributions and not tax-deductible, we like them because you get tax diversification during retirement. Your 401K and IRA will be taxed when you start taking distributions for income during retirement. In addition to that, you may owe a portion of taxes on your social security. Having a Roth IRA allows you be strategic in where you withdraw income in order to keep your taxable income lower and not jump into a higher tax bracket. To be able to balance and diversify your income between taxed and non-taxed distributions is beneficial. In addition, if for some reason you had to withdraw money before age 59 ½ and your distribution is not qualified, you will only be taxed and penalized (10%) on the earnings in the account. Any contributions to a Roth IRA can be withdrawn at any time. Qualified distributions include first-time home purchases, usually capped at $10,000, college expenses for you or your dependent, and birth or adoption expenses. I do want to mention the 5 year rule. Again, you can take out your contributions you put into the Roth IRA with no penalties or tax implications, but the earnings in the account will be taxed and penalized if you have not held the Roth IRA for 5 years. You will see the list of advantages and disadvantages below. Usually the advantages far outweigh the disadvantages making a Roth IRA a great retirement benefit.

ADVATAGES

- Tax-free distributions if qualified
- Tax deferred growth
- Contributions put in can be withdrawn at any time, only earnings will incur taxes and penalty if the withdrawal is not qualified.
- Tax diversification in retirement
- Can be used to pay for education expenses tax and penalty free.
- Can be used toward a first-time home purchase
- No RMD (required minimum distribution

DISADVANTAGES

- Not tax deductible
- Low contribution limits
- Income limits for eligibility
- 5 year rule: you will pay tax and penalty on earnings if Roth Ira has not been held for at least 5 years
- Can incur tax and penalty on earnings withdrawals before age 59 ½

You might be wondering if you are eligible to contribute to a Roth IRA and how much can you contribute? The 2021 max contribution is $6000, plus $1000 catch-up contribution if you are over age 50 for a total of $7000. While $6000 is the max contribution limit, you need to check to see if you qualify based on your personal tax situation. Qualification is based on your MAGI- modified adjusted gross income so you will want to check with your CPA to confirm if you qualify in the event that you are close to the limits in the chart below.

2021 Roth IRA Income and Contribution Limits

Filing Status	MAGI	Contribution Limit
Married filing jointly		
	Less than $198,000	$6,000 ($7,000 if age 50+)
	$198,000 to $207,999	Begin to phase out
	$208,000 or more	Ineligible for direct Roth IRA
Married filing separately*		
	Less than $10,000	Begin to phase out
	$10,000 or more	Ineligible for direct Roth IRA
Single		
	Less than $125,000	$6,000 ($7,000 if age 50+)
	$125,000 to $139,999	Begin to phase out
	$140,000 or more	Ineligible for direct Roth IRA

Now that we have established eligibility requirements and gone over the pros and cons of the Roth IRA, you need to know how to start contributions? Some 401K plans offer a Roth 401K option. You can contribute both pre-tax and after-tax in that scenario. You always want to check and see if your employer will match Roth contributions, or if it is only pre-tax contributions. I personally think it is good to do pre-tax in your 401K as it reduces your taxable income and you are able to put more away since it is coming out of your paycheck before taxes are taken out. Then diversify by opening a Roth IRA at a reputable financial institution with a financial advisor, or if preferred, you can establish a Roth IRA through a discount brokerage firm and manage it yourself.