Learn the ABCs of IRAs before investing

Every month, we put some money into a traditional 401K for retirement, but we wonder if we should start putting some of that money into a Roth IRA instead. What are the pros and cons?

You need to take lots of things into account in deciding between a Roth IRA, or individual retirement account, and a traditional IRA. Each type of investment has its own rules and regulations. But let's just focus on the basics:

• **Contributions.** A Roth IRA doesn't offer any tax benefits at the starting gate. Whatever you invest comes directly out of your pocket.

On the other hand, traditional IRAs offer an immediate payoff, as you are probably aware from your 401K account (which is a type of IRA). Let's say you contribute $300 a month to a traditional IRA, for a total of $3,600 a year. That amount isn't counted in your income when your annual tax bill is calculated — it would be as if your income was $3,600 less than what you actually earned.

Since your tax bill is lower, that $300 monthly contribution actually costs you less than $300. How much less? That depends on your filing status, tax bracket, deductions and exemptions. But it's less. So, you're making a $300 a month investment in your future at a cost of, say, $225 a month. Not bad.

By effectively lowering your income, you may also make yourself eligible for other tax benefits, such as the student loan interest deduction or child tax credit. Keep that in mind as you a decision between a traditional and a Roth IRA.

• **Withdrawals.** Here's where the Roth IRA shines. Since you've already paid taxes on the money you have invested in a Roth IRA, the money you withdraw from the account is tax-free. So, if you take $10,000 from your Roth retirement account under normal terms and conditions, you'll have $10,000 to do with as you wish.

With a traditional IRA, withdrawals are treated as income. The higher your income, the more Uncle Sam gets, so a $10,000 withdrawal from a traditional IRA may only mean $7,500 in your pocket. Again, it could be more or less, depending on your tax bracket.

Another thing to keep in mind: Let's say you've contributed $30,000 over the years in a Roth IRA, but your investment has done well and your account has ballooned to be worth, say, $50,000. When you make your withdrawals, you don't need to pay income tax on either the $30,000 initial contribution or on the additional $20,000 that the investment earned. That can be a considerable benefit of a Roth IRA over a traditional IRA.

There are plenty of other considerations to be aware of when deciding if contributing to a Roth is right for you. You can learn more by searching for "IRAs" at extension.org, a resource that provides expertise from land-grant universities nationwide.

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By Martha Filipic
614-292-9833
filipic.3@osu.edu

Dear Subscriber: This column was reviewed by Betsy DeMatteo, family and consumer sciences educator for Ohio State University Extension.

College Communications
2021 Coffey Road
Columbus, OH 43210-1043
614-292-2011

208 Research Services Building
1680 Madison Ave.
Wooster, OH 44691-4096
330-263-3780