5 Steps To Choosing Between A Roth IRA And A Traditional IRA Contribution

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You have until April 15, 2019 to make your IRA contribution for 2018. Until then, one of the decisions you must make is whether that contribution should be made to a traditional IRA or a Roth IRA.

With a traditional IRA, any earnings would grow tax deferred, but are taxable when distributed to you. With a Roth IRA, any earnings also grow tax-deferred, but are tax free if your distributions are qualified. Your Roth IRA distribution is qualified if it occurs at least 5 years after you fund your first Roth IRA; and, you are at least age 59½ or disabled or the distribution is used for first- time homebuyer purposes- subject to a lifetime limit of $10,000.

While income tax is likely a key driver for your choice, there are other factors that must be taken into consideration, including eligibility. To help ensure that you make the right and suitable choice, consider using the following 5-step process as part of your decision-making process.

1. **Make Sure You Received Eligible Compensation for 2018**

    You must have received eligible compensation in 2018, in order to be eligible to make a contribution to an IRA for 2018. Eligible compensation generally includes payments that you received for working or providing services. Examples include wages, salaries, tips, bonuses, professional fees, self-employment income (IRS Pub 590-A).

    Investment income and rental income are examples of income that are not considered 'compensation' for purposes of being eligible to make a contribution to an IRA.

    Consult with your tax professional to determine whether income that you received during 2018 is eligible to be considered compensation for IRA contribution purposes.

    Important Note: Contribution Cap

    Your regular IRA contribution for 2018 cannot exceed the lesser of 100% of your eligible compensation or $5,500. If you were at least age 50 by December 31, 2018 you can make an additional catch-up contribution of $1,000.

2. **Check Your Age For Traditional IRA Contributions**

   If you were at least age 70½ on December 31, 2018 you are not eligible to make a regular contribution to a traditional IRA for 2018. Instead, you may make your contribution to a Roth IRA, providing your modified adjusted gross income (MAGI) does not exceed the limit that applies to your tax filing status (see number 3 below).

3. **Check Your MAGI Limit For Eligibility For Roth IRA Contributions**

   You are eligible to make a regular contribution to a Roth IRA, as long as your MAGI is not:

   - $135,000 or more, if your tax filing status is Single
   - $199,000 or more, if your tax filing status is Married Filing Jointly
   - $10,000, if your tax filing status is Married Filing Separately

   If your MAGI falls within the following phase-out ranges, the amount of contribution that you are eligible to make to a Roth IRA is reduced below the $5,500 limit ($6,500 if you were at least age 50 by 12/31/2018).

   - $120,000 to $135,000, if your tax filing status is Single
   - $189,000 to $199,000, if your tax filing status is Married Filing Jointly
   - Up to $10,000, if your tax filing status is Married Filing Separately

   If your MAGI falls within the range that is tied to your tax filing status, consult with your tax professional to determine how much you are eligible to contribute.

   You are eligible to contribute the full amount (See "**Important Note:** Contribution Cap" above), if your MAGI is under $120,000 and your tax filing status is Single; or $189,000 if your tax filing status is Married Filing Jointly.

   Tip: If you prefer the Roth IRA, but your MAGI is too high, you could use the Backdoor Roth IRA contribution strategy to get the funds into your Roth IRA.

4. Check Eligibility For Deductibility Of Traditional IRA Contribution

If you received contributions or benefits under an employer sponsored retirement plan for 2018, your eligibility to claim a tax deduction for your 2018 traditional IRA contribution depends on your 2018 MAGI.

If your tax filing status is Single

- Your contribution is fully deductible, if your MAGI is $63,000 or less
- You are eligible to deduct only a portion of your contribution, if your MAGI is between $63,000 to $73,000 (the phase-out range)
- You are not eligible to claim a deduction if your MAGI is $73,000 or more

If your tax filing status is Married Filing Jointly

- Your contribution is fully deductible, if your MAGI is $101,000 or less
- You are eligible to deduct only a portion of your contribution, if your MAGI is between $101,000 to $121,000 ($189,000 to $199,000, if your spouse is the one who received contributions or benefits under an employer plan, and you did not
- You are not eligible to claim a deduction if your MAGI is $121,000 or more

If your tax filing status is Married Filing Separately

- You are eligible to deduct only a portion of your contribution, if your MAGI is up to $10,000 (the phase-out range)
- You are not eligible to claim a deduction if your MAGI is $10,000 or more

If your MAGI falls within the phase-out range, your tax professional can help you to determine how much of your contribution you are eligible to deduct.

If you cannot take a deduction from your traditional IRA contribution, you may still make a nondeductible contribution to your traditional IRA. Amounts attributed to nondeductible contributions are nontaxable when distributed from your IRA, but any earnings would be taxable.

Tip: If you are not eligible to claim a deduction for traditional IRA contribution, but you are eligible to make a contribution to a Roth IRA, it makes better tax and financial sense to make the contribution to your Roth IRA.

Illustration: Contribution amount

	Tradition IRA	**Roth IRA**
Contribution amount	$5,500	$5,500
Earnings	$1,000	$1,000
Deductions	$$0.00	$$0.00
Cost to you	$5,500	$5,500
Amount taxed when full balance is distributed	$1,000	$0.00 *

** With the Roth IRA, you get the earnings tax free, providing the distribution is qualified.*

5. Check Suitability

If you are eligible to make contributions to both a traditional IRA and a Roth IRA, your decision would then be based on which is most suitable for you. A suitability assessment is usually done by a financial or tax advisor, who would include certain factors that can reasonably estimate which of the two options would result in you paying the least amount of income taxes in the end.

Your current income tax rate and your projected income tax rate, at the time you would likely be taking distributions, is a key determining factor for the amount of income tax that would apply.

Your advisor should also consider how giving up a deduction on the traditional IRA side compares with getting tax-free income on the Roth side. The results would be based on your specific tax and financial profile.

If you make too much to contribute to a Roth IRA directly but still want one, see **How The Backdoor Roth Contribution Works.**

You Can Split The Difference

If you are unsure about which IRA to choose, you can split your contribution between both types of IRAs, if you are eligible to do so. When doing so, make sure that your total contributions to both accounts do not exceed the lesser of 100% of your eligible compensation or $5,500- plus an additional catch-up contribution of $1,000 if you are at least age 50 by the end of the year.

Work With A Financial Advisor

You can set up and fund your IRA on your own. Your options include your local banks, mutual fund companies and brokerage firms. The option that is most suitable for you will depend on several factors including your account balance- as some financial institutions have minimum balance requirements, whether the type of investments that are suitable for you are available, and the level of support that the financial institution provides.

Working with a financial advisor can help you to identify the option that is most suitable for you.