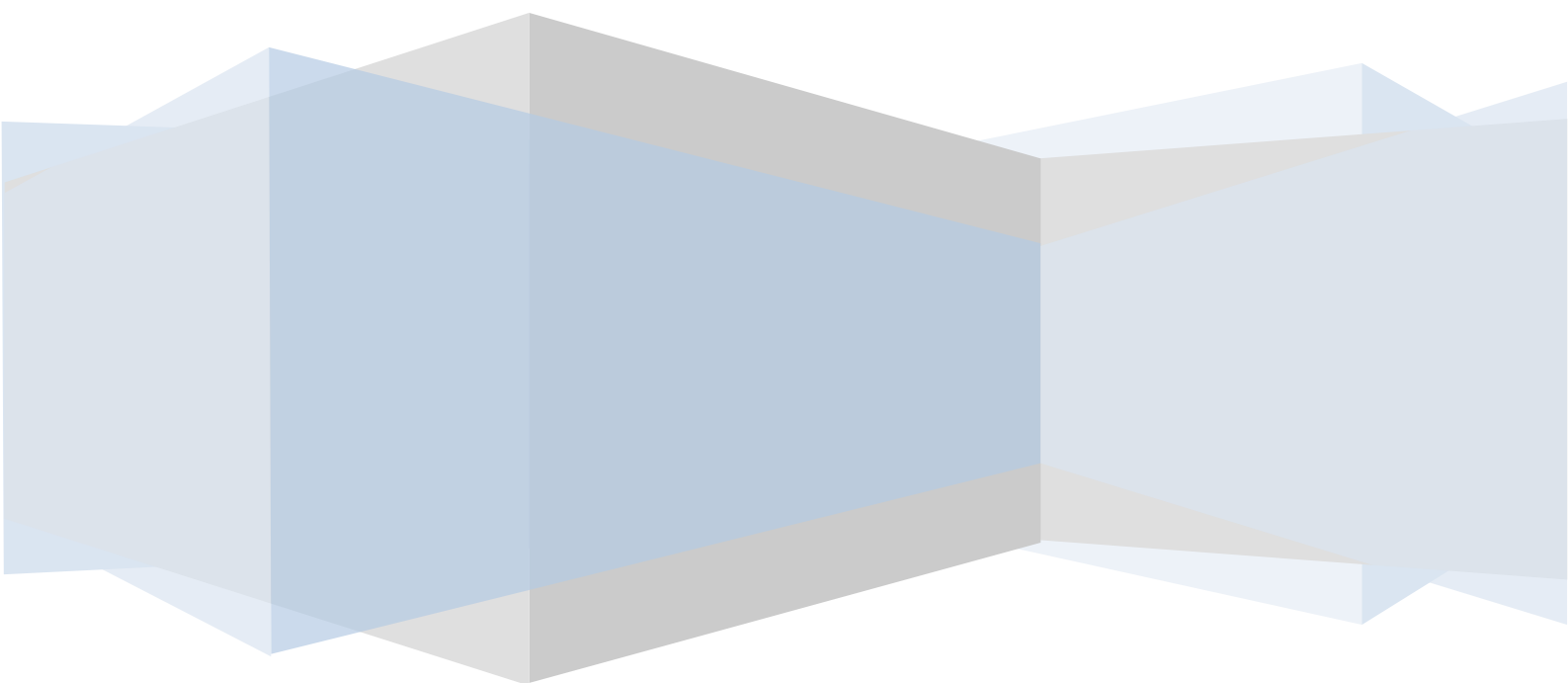




Roth vs. Traditional IRAs

Your guide to a better understanding
of the IRA options available to you through
Firsttrade.com.





Understanding Individual Retirement Accounts

Saving for Retirement

There is no question that adequate retirement savings are crucial to every investor's future, but choosing the right account to save that money in is not an easy task. There are tax considerations to make, retirement planning options to consider and benefits and drawbacks to each type of IRA that investors must evaluate before they decide which to open and begin contributing to. The biggest decision investors must make is not *whether or not* to open an IRA account to save for retirement, but whether to open a **Roth IRA** or a **Traditional IRA**.

Traditional IRAs

General

Traditional IRAs provide a benefit to investors during the year that a contribution is made and over all the years they save for retirement. Contributions to Traditional IRAs are tax deductible, as long as the participant is not covered by an employer's retirement plan or—if they are—they meet certain income requirements ([found here](#)). These contributions are allowed to remain in the IRA account and grow tax-deferred so no capital gains or income taxes are due even as interest is earned or positions are liquidated within the IRA to realize gains.

Traditional IRAs only permit contributions to be made until the participant reaches the age of 70 ½. At that point, distributions are required to be taken. These distributions are called Required Minimum Distributions, or RMDs, and their annual amount is based on a formula that evaluates the prior year's IRA balance and the participant's current life expectancy.

Participants do not need to wait until they reach 70 ½ before they take distributions, however. In fact, they may begin taking distributions without penalty once they reach age 59 ½. All distributions are taxable at the participant's tax rate at the time of distribution, but those taken before age 59 ½ may also be subject to IRS penalties for early withdrawal.

Contribution Limits

IRA participants may make up to \$5,000 in contributions for 2011 if they are age 49 or younger. Those who reach age 50 by the end of the year may make an additional "catch-up" contribution of \$1,000.

Firsttrade makes it easy for you to schedule automatic withdrawals from your bank account to your IRA so you can make sure you get the full deduction each year.

Permissible Investments

IRA participants using Firsttrade as a custodian may invest in many different vehicles including stocks, bonds, treasuries, CDs, exchange traded funds, money market funds, money market accounts, mutual funds and covered call options.



Roth IRAs

General

Roth IRAs are substantially different from Traditional IRAs. First, the contributions made to a Roth IRA are not tax deductible. However, this is balanced out by the fact that distributions from a Roth IRA taken after age 59 ½ (as long as the IRA has been open at least 5 years) are tax-free. This means that assets can grow within a Roth IRA and, if the participant times his or her distributions properly, they will not need to pay any taxes on those gains.

Another important difference is that Roth IRA participants are not required to take distributions at any age and may continue making contributions as long as their income meets requirements. For those concerned about leaving a legacy behind for their heirs, a Roth IRA offers greater planning opportunities since the funds within can remain untouched for the life of the participant.

Like a Traditional IRA, Roth IRA distributions that are not qualified (i.e. those that are taken before age 59 ½) are partially taxable and subject to IRS penalties.

Contribution Limits

Individuals age 49 or younger may contribute up to \$5,000 to their Roth IRAs in 2011. Those who will be age 50 or older by the end of the year may make an additional contribution of \$1,000.

Roth IRAs do impose income limitations. Participants filing jointly with an adjusted gross income (AGI) greater than \$168,999.99 or filing single, head of household or married filing separately with an AGI greater than \$106,999.99 are subject to additional contribution limitations. You can access the full details of the limitations [here](#).

Roth IRAs also have AGI limitations imposed for the opening of an account. Individuals filing jointly must not have an AGI exceeding \$178,999.99 and single, head of household or married filing separately filers must not have an AGI exceeding \$121,999.99 if they want to open a Roth IRA.

It can be difficult to remember to make your contributions each year in order to maximize your retirement savings, but Firsttrade's easy automatic ACH system allows you to schedule regular transfers from your bank account to your Roth IRA.

Permissible Investments

Like a Traditional IRA, Roth IRA participants are permitted to invest in many of the options Firsttrade has available, including stocks, bonds, treasuries, CDs, exchange traded funds, money market funds, money market accounts, mutual funds and covered call options.



Cutting Through the Jargon— Tax-Free versus Tax-Deferred

Understanding Tax-Free and Tax-Deferred Accumulation

Tax-deferred and *tax-free* are two different concepts. Something that is tax-deferred is something that must eventually have taxes paid on it. Something that is tax-free will not need any tax payments made.

One of the biggest differences between types of IRA accounts discussed above is in their tax set up. Roth IRAs offer tax-free asset accumulation because contributions are made with after-tax dollars and the gains made by those contributions, once they are in the account, is tax-free as long as they are not withdrawn before age 59 ½ and the account has been open at least five years.

Traditional IRAs, on the other hand, offer tax-deferred growth after the tax deductible contribution is made. So in addition to getting a tax deduction on an IRA contribution, the deposited funds are allowed to grow within the IRA without taxes due until they are withdrawn. When withdrawn at retirement, the funds will generally be subject to a lower tax rate than they would have been if payable before retirement because a post-retirement income is likely to be much lower than a pre-retirement income and subsequent tax rate.

Resources

¹The Internal Revenue Service. (2010, January). Publication 590: Individual Retirement Arrangements (IRAs). Retrieved December 29th, 2010 from <http://www.irs.gov/pub/irs-pdf/p590.pdf>.

²The Internal Revenue Service. (2010, November). 2011 IRA Contribution and Deduction Limits. Retrieved December 29th, 2010 from <http://www.irs.gov/retirement/article/0,,id=202510,00.html>.

³The Internal Revenue Service. (2010, November). 2011 Contribution and Deduction Limits. Retrieved December 29th, 2010 from <http://www.irs.gov/retirement/participant/article/0,,id=202518,00.html>