info sheet Roth IRA: a retirement investment choice

As you prepare for retirement, it's a good idea to become familiar with all of the investment vehicles available to you. Historically, retirement investors have been limited to contributing to a traditional Individual Retirement Account (IRA) and/or company-sponsored 401(k) or 403(b) plans. In 1998, however, the Roth IRA burst onto the scene as a third option for investors looking to make their retirement years more comfortable.

Why should you consider investing in a Roth IRA?

IRAs in general offer a number of advantages that make them appealing to investors. In the case of the traditional IRA, contributions may be deductible under certain circumstances. In addition, earnings on contributions can accumulate tax deferred.

This simply means that investors are not required to pay taxes on contributions or earnings growth as long as the money stays in the IRA. Contributions can be made to a traditional IRA until the account owner is age 70½, at which point he or she must begin taking mandatory distributions.

A Roth IRA, on the other hand, allows earnings on contributions to accumulate tax free past age 70½. Investors in a Roth IRA will never have to pay taxes on the earnings portion of their contributions, provided the account is more than five years old and the account owner is older than age 59½.

Additionally, you can make nondeductible contributions to a Roth IRA for as long as you want, even after age 70½. For both the traditional IRA and the Roth IRA, there is a 10% federal penalty tax on certain withdrawals taken prior to age 59½.

Who is eligible?

While almost anyone who is actively employed is qualified to contribute to a traditional IRA, there are eligibility requirements for investing in a Roth IRA. In general, single people with an adjusted gross income (AGI) of less than $110,000 and married people with a combined AGI of less than $160,000 are eligible to make at least partial contributions each year.

Below is a breakdown of eligibility:

Married (filing jointly)

- full contribution if AGI is $150,000 or less
- partial contribution if AGI is $150,000–$160,000

Single

- Full contribution if AGI is $95,000 or less
- Partial contribution if AGI is $95,000–$110,000

	Maximum contribution limit
2002–2004	$3,000
2005–2007	$4,000
2008	$5,000

adjust for inflation thereafter

Remember, if you are at least 50 years old, you are eligible to make additional catch-up contributions each year of $500 for 2002–2005 and $1,000 in 2006 and thereafter.

Is a Roth IRA right for you?

Just because you are eligible to contribute based on your AGI doesn't mean a Roth IRA is the best product for your individual situation. Your overall investment objectives and retirement time frames will have a significant impact on which type of IRA you eventually choose.

To give you an idea of who might benefit, however, it might be helpful to start with some general guidelines. A Roth IRA may be right for you if you

- participate in a 401(k) or 403(b) with limits on matching company contributions
- participate in a 401(k) or 403(b) with no matching company contributions
- are already making nondeductible contributions to a traditional IRA and have an investment horizon greater than 10 years
- want tax-free payments to a beneficiary

Again, these are rough guidelines, and there may be other factors to consider that are unique to your situation. That's why it's important for you to discuss your options with your investment professional before making a decision.

Roth IRAs are flexible in times of need

Because your annual Roth IRA contributions are nondeductible, you can always withdraw up to the amount of your contributions without incurring taxes or penalties. Once the Roth IRA is five years old, the IRA also permits tax-free and penalty-free withdrawals of investment gains if the withdrawal is a "qualified distribution." A distribution is qualified if it is made

- after age 59½
- due to death or disability
- for a first-time home purchase ($10,000 limit)

Please note: If you convert a taxable amount from a traditional IRA to a Roth IRA and you take a withdrawal from that amount within five years of the conversion, the withdrawal will be subject to a 10% penalty tax unless an IRS exemption applies. The "qualified distributions" described above are exempt from the penalty, as are distributions made to cover certain medical, educational, and health insurance expenses. Keep in mind that when you take money out of any IRA, it is not a loan that can be paid back. If at all possible, you should consider using other assets before taking premature withdrawals from an IRA.

What's my first step?

The first thing you must do is sit down with your investment professional to discuss your current situation and your retirement goals. Factors such as the number of years until retirement, lifestyle goals, and future tax brackets will play a large role in helping you decide which type of IRA might be more effective in helping fund your retirement.

Now, assuming you settle on a Roth IRA, you then need to determine how much you would like to contribute and how often. Most institutions offering Roth IRAs will let you invest in a lump sum or at regular intervals: monthly, bimonthly, or quarterly.

If you already have one or more IRAs or are contemplating converting one or more existing traditional IRAs to a Roth IRA, consider consolidating them into a single Roth IRA (see "IRA Rollovers" info sheet). Doing so will not only simplify your recordkeeping now and your distributions later, it may also save you money in annual IRA trustee fees.

The cost of waiting

As convenient, tax appealing, and flexible as a Roth IRA is, however, it's you that has control over its most attractive feature — the power to accumulate over time. The chart below illustrates how $1,000 invested at the beginning of each year would grow at an assumed 8% annual rate of return.

Invested per year	Starting age	Total value at age 65
$1,000	35	$122,346
$1,000	36	$112,283
$1,000	40	$78,954
Cost of waiting one year		$10,063
Cost of waiting five years		$43,392

As you can see, the earlier you start investing, the better. And, while a Roth IRA is by no means the answer to all of your retirement needs, opening one sooner rather than later could very well mean the difference between living a comfortable retirement and enjoying the retirement of your dreams.

Resources for further information

Bledsoe, John D. *Roth to Riches: The Ordinary to Roth IRA Handbook*, Legacy Press, 1998, 206 p., $19.95.

Trock, Gary R. *The Roth IRA Made Simple*, Conquest Publishing, 1998, 165 p., $14.95.

Daryanani, Dr. Gobind; Roth, William V.; and Alter, Murray. *Roth IRA Book: An Investor's Guide*, Digiqual Inc., 258 p., $34.95.

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