

RETIREMENT



ROTH IRA: A RETIREMENT INVESTMENT CHOICE

When saving for retirement, it is a good idea to become familiar with all of the investment vehicles available to you. Historically, many retirement investors have saved by contributing to a traditional individual retirement account (IRA) or an employer-sponsored 401(k) or 403(b) plan. The Roth IRA is another 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 features and advantages. In the case of the traditional IRA, contributions may be deductible under certain circumstances. In addition, earnings on contributions can accumulate tax deferred.

This means simply that investors are not required to pay taxes on deductible 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, does not require the owner to take distributions at age 70½. Unlike contributions made to a traditional deductible IRA, Roth contributions are not tax deductible. Investors in a Roth IRA will not have to pay taxes on withdrawals of the earnings portion of their account provided the account is at least five years old and the account owner is at least age 59½ when withdrawals are taken.

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 the taxable portion of any withdrawals taken prior to age 59½ unless an exception applies.

Key points

- Earnings accumulate tax deferred in a Roth IRA and may be distributed tax free after you reach age 59½ if you have had the account for at least five years.
- With a Roth IRA, contributions may be withdrawn at any time with no tax consequences.
- For individuals who want to leave assets to their heirs, a Roth IRA does not require distributions to the owner at age 70½, but non-spouse beneficiaries will be required to take distributions after the owner's death.

This material should be used as helpful hints only. Each person's situation is different. You should consult your investment professional or other relevant professional before making any decisions.

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Who is eligible?

While almost anyone receiving earned income from employment is qualified to contribute to a traditional IRA, there are eligibility requirements for investing in a Roth IRA. In general, in 2019, a single person with a modified adjusted gross income (MAGI) of less than \$137,000 and a married couple with a combined MAGI of less than \$203,000 are eligible to make at least partial contributions each year. Below is a breakdown of eligibility:

Single

- full contribution if MAGI is less than \$122,000
- partial contribution if MAGI is \$122,000 to \$137,000

Married (filing jointly)

- full contribution if MAGI is less than \$193,000
- partial contribution if MAGI is \$193,000 to \$203,000

Maximum contribution limit for 2019

- Under age 50 \$6,000
- Age 50 and over \$7,000

Future years will be indexed for inflation.

Source: IRS 2019.

Is a Roth IRA right for you?

Just because you are eligible to contribute because you meet the income-based eligibility requirements does not mean a Roth IRA is the best product for your individual situation. Your overall investment objective, risk tolerance and retirement time frame will have a significant impact on which type of IRA you eventually choose.

A Roth IRA may be right for you if you

- prefer tax-free distributions over a tax deduction now
- do not want to have required minimum distributions at age 70½
- are already making nondeductible contributions to a traditional IRA
- want potentially tax-free payments to a beneficiary

These are only some of the considerations, and there may be other factors to consider that are unique to your situation. That is why it is important for you to discuss your options with your financial advisor 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
- because of 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 (special rules apply in the case of a “qualified reservist distribution”). If at all possible, you should consider using other assets before taking premature withdrawals from an IRA.

What's your first step?

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

Now, assuming you are eligible for and settle on a Roth IRA, you then need to determine how much you can 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 the “Consolidating Retirement Plan Assets” infosheet). Doing so will not only simplify your recordkeeping now and your distributions later, it also may save you money in annual IRA trustee fees.

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Roth conversion

Everyone, regardless of income, is able to convert traditional IRAs into Roth IRAs. This has many investors asking if they should convert some, or all, of their retirement assets into Roth IRAs. There is no single answer to this important question, but one of the key factors to consider when deciding about whether to convert assets and how much to convert is your tax situation.

Pay taxes now or later?

Are you better off paying taxes now or later? Your decision about Roth conversion may be based on the answer to this question. That's because of two factors unique to the Roth IRA:

- Withdrawals from a Roth can be tax free. Each Roth conversion has its own five-year holding period. Once you have had the conversion Roth for five years or more, any distributions made from it after you are age 59½ are tax free. There are other types of withdrawals that are tax free or tax advantaged. For more details, consult your financial advisor, tax attorney and IRS Publication 590.
- Converting from a traditional IRA to a Roth IRA is a taxable event. When you convert to a Roth IRA, all taxes must be recognized in the year of conversion.

Resource

www.irs.gov

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