M&Y INTERNATIONAL FINANCIAL SERVICES NEWSLETTER

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4 Reasons To Love The Roth IRA

If you earn money, whether in the form of wages, interest, or even gambling winnings, among other things, you are required to pay taxes on that money. And there are very few exceptions to those tax laws. But one particular exception to that rule stands out: The tax treatment of earnings within a Roth IRA. And that special tax treatment leads to four reasons you should love saving for retirement in a Roth account.

"Can you imagine a tax-free retirement? "

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1. Tax-free growth and distributions

In general, when you contribute to a *traditional* IRA, you do so on a pre-tax basis. Your money then has the advantage of being able to grow tax-deferred. But it's important to remember that when you withdraw that money – consisting of both principal and earnings – you will owe ordinary income taxes on your distributions. And when you are in retirement and no longer bringing in income, you will be responsible for paying those taxes either from your retirement accounts or from other sources of funds.

However, with a *Roth* IRA, the money you contribute into the account has already been taxed. Then, as long as you follow some basic account requirements, including having a Roth account open for at least five years, everything you earn within the account will grow tax-free and remain tax-free even when you take a distribution. So, if you put in $5 and it grows to $10 – that $5 of growth is yours, tax-free.

No one knows what the tax rates will be in the future, nor do we know what tax bracket we will be in when we retire. What we do know is the current tax rate and our current tax bracket. And if you save in a Roth today, you generally don't need to worry about future taxes. Whatever you have saved in your Roth IRA will be yours, free and clear.

2. You can leave your Roth untouched throughout your lifetime

In order to encourage individuals to save for retirement, the government allows us to save in tax-favored retirement accounts. But it won't let you avoid paying taxes on your savings forever. For traditional IRAs and 401(k) accounts, at age 70 1/2, you typically must begin taking required minimum distributions (RMDs) from your tax-deferred accounts, at which time you will owe ordinary income taxes. And since you are required to begin drawing down your accounts, you are no longer able to continue contributing money into traditional IRAs past age 70 1/2.

However, these requirements do not apply to the Roth IRA. In fact, you are never required to take distributions from your Roth. Also, you can continue contributing to your account as long as you have taxable compensation, even past age 70 1/2. Ultimately, that allows you to keep your account untouched and intact for your entire lifetime. Which leads us to the next point.

3. You can pass tax-free money to heirs

Another special feature of the Roth IRA is that you can pass the tax-free benefits of the account to your heirs. Like other retirement accounts, if your spouse inherits your Roth IRA, they can treat the account as if it were their own. Therefore, they can continue holding the Roth and are not required to take distributions from it during their lifetime either, thereby allowing it to grow tax-free for even longer if they wish.

If you leave your Roth IRA to someone other than a spouse (and you've had the account open for the required five-year period), then that beneficiary can also enjoy tax-free withdrawals -- however, one note of difference is that they will be required to take minimum distributions.

4. Access to principal

Because contributions to a Roth IRA are made with money that has already been taxed, of course, original contributions are always accessible on a tax-free and penalty-free basis. (Again, see here to learn about when your earnings will also be tax-free and penalty-free.) Keep in mind, though, that this money should be earmarked for your future retirement and should only be used as a last resort in case of a true emergency.

When it comes to retirement planning, consideration of taxes should be a big part of your overall strategy. But because your retirement might be decades away, it's hard to know what tax laws will be in place at that time. The smart thing might be to diversify your retirement accounts based on their tax treatment, and a Roth IRA, providing tax-free retirement income, may be a great place to start.

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