Traditional or Roth IRA? One Has an Absolute Benefit | Investopedia

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When given the choice, I suggest people take advantage of a sure thing now ("current absolute benefit") instead of risking an undefined future ("future uncertain benefit"). In this regard, I tell all of my clients to take a guaranteed tax deduction now by investing in a tax-deductible traditional IRA or 401(k) instead of risking unknown future tax benefits by contributing to Roth IRA or Roth 401(k) plans.

Remember that you receive an immediate income-tax deduction on a 401(k) or most traditional IRA contributions and only pay taxes when you withdraw funds—usually after you are retired, when your income tax bracket is lower—meaning you absolutely receive a current benefit. In contrast, Roth accounts require you to pay income taxes on your earnings prior to your contribution, then you avoid paying taxes on gains and withdrawals from the account. In addition, unlike IRAs that require you to take future taxable required minimum distributions (RMDs), Roths do not require future distributions as long as the accounts are in your name. Given this framework, Roths do sound good for the future, provided the future goes as you predict.

Recommending Roth IRAs to Young Investors

In the late 1990s, during my career as a certified financial planner, I had access to software that allowed me to run many types of financial calculations. One common calculation we illustrated for young, less-wealthy individuals was whether it made more sense to contribute to an IRA or a Roth. The reasoning was that a person early in his career would have low income now and larger income in the future, so an income-tax deduction from funding an IRA looked less attractive than paying taxes now and investing in a Roth instead. These young individuals could withdraw contributions and limited gains without a penalty for a first-time home purchase, and if the client was successful in the future and did not need the money in the Roth, it continued its compound growth since there were never any RMDs. (For related reading, see: *Roth vs. Traditional IRA: Which Is Right For You?*)

The government also dangled a carrot in front of these people by saying anyone with a half-way respectable income couldn't even contribute money to a Roth; Roths became forbidden fruit that the wealthy could not attain. These young investors looked like they would be working for the next 50 years, so why not show them what all of that future tax-free money would look like when they turned 80, 90 or even 100? And since it was the 1990s, we illustrated 10% annual investment gains and everyone imagined themselves as future tax-free multi-millionaires. No one could resist a Roth IRA.

Traditional IRAs Provide Guaranteed Tax Benefit

So on the surface Roths sound pretty good, right? But think of this: You can make an instant guaranteed 30% return on your investments (an IRA income-tax deduction), or make no immediate gain for an unknown benefit in the future that could look awesome (pay after-tax money to my Roth and wait for a future unknown tax savings).

Yes, the sole reason to invest in an IRA instead of a Roth is the uncertainty of tax policy. Because the entire equation is based on when and how much money we save on income taxes, this calculation favors a Roth IRA in a world where the laws of taxation remain static and stable for the rest of your life. (For related reading, see: *Traditional and Roth IRAs: Which Is Better for Taxes?*)

Since the introduction of Roth IRAs 20 years ago, we have seen new upper and lower tax rates, differing tax brackets, permissible deductions, increased levels of maximum retirement plan contributions, a lifting on income caps on Roth IRA conversions and many other changes to income tax deductions.

By the way, when you die, any beneficiary other than your spouse has to take RMDs. True, they don't pay taxes, but they are depleting the account nonetheless. In addition, the previous administration proposed mandating RMDs from Roth IRAs, which would essentially force money to be withdrawn from Roths and then reinvested in investments that would be eligible for income taxes on any gains and distributions made from them. Fortunately, this legislation did not pass yet, but who knows what the future holds? (For related reading, see: *Is the Roth IRA Under Threat?*)

We clearly live in a world where future taxation remains uncertain.

And that's just the money you pay the IRS. At the state level, some states allow you to take some or all of your IRA distributions free from state income taxes.

What a Roth IRA Has to Return to Be Worthwhile

Lastly, if your investments in your Roth perform poorly, the entire purpose of the future tax-free growth of the Roth is rendered moot: While a tax-deductible IRA contribution automatically guarantees savings on income taxes, you need the Roth to return at least the amount that was paid in taxes when you funded the Roth to make the Roth worth it. The fact that every financial company states that past investment results do not guarantee future gains is just a fancy way of saying “No one knows what will happen with your investments in the future.”

I am not saying never invest in a Roth IRA. By all means, please do. But if you have limited funds, you should use them to first invest in the deductible IRA so you are guaranteed a benefit. (For related reading, see: *5 Secrets You Didn't Know About Traditional IRAs*.)

The answer to the “IRA or Roth” question is, was, and will continue to be very simple: In a world where the rules are always changing, take the current absolute benefit (a certain, defined, immediate tax deduction from contributing to a traditional IRA), even if it only saves you 10%-20% on income taxes, over the future uncertain benefit (who knows what the future holds for tax policy and Roth IRA features and benefits). In a world where the future is uncertain and any forthcoming benefit cannot be guaranteed, choose the sure winner. When you can only invest in one account, take a tax deduction now by investing in your tax-deductible IRA instead of investing in a Roth.