

# Know The Difference: Traditional IRA vs. Roth IRA

An IRA is a common vehicle for retirement savings. These accounts have major benefits, as capital gains, dividends, and interest are not taxed, effectively allowing holders to grow their wealth without growing their annual tax bill. But they're not without their fine print.

One of the biggest questions when considering IRAs is determining which account type is right for you: a traditional IRA, or a Roth IRA.

The difference between the two lies in how each one handles taxes.

## Traditional IRAs

A traditional IRA offers upfront perks.

Funds contributed to a traditional IRA lower the holder's tax bill for that calendar year, functioning like a deduction. For example, if Scott makes \$50,000 in 2024 and places \$6,000 in a traditional IRA, he will be taxed on just \$44,000. The funds then grow in the account with no taxes on capital gains, dividends, and interest.

This gives account holders an impressive near-term benefit, but the check comes eventually. Come retirement, any funds withdrawn are taxed like regular income.

The advantage of traditional IRAs is that the account holder will be in a lower tax bracket at the time of retirement, since they have no earned income. So even when funds are withdrawn, they will typically be taxed at a lower rate.

## Roth IRAs

A Roth IRA is essentially the opposite of a traditional IRA. It imposes a higher tax burden in the short-term, but can provide significant benefits in the long run.

Funds contributed to a Roth IRA do not lower the account holder's tax bill for that year. For example, if Scott makes \$50,000 in 2024 and places \$6,000 in a Roth IRA, he will be taxed on all \$50,000. Like with traditional IRAs, the funds then grow with no taxes on gains, dividends, or interest.

However, unlike traditional IRAs, qualified withdrawals from a Roth IRA are tax-free. This makes Roth IRAs a great tool for people early in their careers, who are most likely in a lower tax bracket already, and will also have more time to allow those gains to build.

## The Big Question

So which is better, a traditional IRA or a Roth IRA?

The answer to this is another question. Are you in a higher tax bracket now than you will be in retirement? The answer to *that* question should give you insight into which IRA account type is the best choice for you.