THE WALL STREET JOURNAL.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit http://www.djreprints.com.

http://blogs.wsj.com/experts/2016/05/12/when-a-roth-ira-is-a-wrong-choice/

THE EXPERTS | WEALTH MANAGEMENT

When a Roth IRA Is a Wrong Choice

WSJ Wealth Management Expert Jonathan Guyton discusses how a Roth IRA isn't always a tax-savvy option for retirement savers. *PHOTO: ISTOCK*

By

JONATHAN GUYTON

May 12, 2016 6:15 am ET

Jonathan Guyton is principal at Cornerstone Wealth Advisors Inc., a fee-only advisory firm in Minneapolis.

Contributing to a Roth individual retirement account if you meet the income requirements is standard advice. But there are cases when it may not be sound advice.

The key is whether your income “fills” the lowest tax brackets; this happens when your taxable income exceeds $37,450 if you’re single and $74,900 if you’re married filing jointly with your spouse. While everything below these levels is taxed at 15% or less, anything beyond is taxed at 25% or higher. That’s a big jump in tax rates! In fact, it’s the biggest in the entire tax code.

This

MORE IN WEALTH MANAGEMENT

- Why I Use Savings Bonds to Fund My Emergency Account (http://blogs.wsj.com/experts/2016/06/16/why-i-use-savings-bonds-to-fund-my-emergency-account/)
- Quizzes for Couples to Get to Know Each Other Financially…Before It's Too Late (http://blogs.wsj.com/experts/2016/06/15/quizzes-for-couples-to-get-to-know-each-other-financiallybefore-its-too-late/)
- Why the Conventional Wisdom About Investing in Volatile Markets May Be Wrong (http://blogs.wsj.com/experts/2016/06/14/why-the-conventional-wisdom-about-investing-in-volatile-markets-may-be-wrong/)
- How to Calculate Whether a Credit-Card Fee Is Worth It (http://blogs.wsj.com/experts/2016/06/13/how-to-calculate-whether-a-credit-card-fee-is-worth-it/)
- Spend Down or Gift Retirement Accounts? Here's Some Math (http://blogs.wsj.com/experts/2016/06/10/spend-down-or-gift-retirement-accounts-heres-some-math-2/)
- Why Investors Should Be Wary of Crowdfunded Securities (http://blogs.wsj.com/experts/2016/06/07/why-investors-should-be-wary-of-crowdfunded-securities-2/)

makes the Roth-or-not decision quite straightforward. Let's say your taxable income (line 43 on Form 1040) is currently above these levels and that, beyond your matched 401(k) contribution, you want to save another $5,000 of your salary for retirement. You could authorize this to also go to your traditional pretax 401(k). If you did and earned a 7% average annual return for the 30 years thereafter, it would become $29,668. But this money is yet untaxed.

Because single retirees can often have $50,000-$60,000 incomes–and married couples $100,000-$120,000–while remaining in the lower tax brackets, it's very possible the tax hit will be 15% for federal tax and, say, 5% for a state income tax. (These income thresholds are indexed to inflation, so they will more than double in 30 years.)

Thus, the $5,000 added to your 401(k) would generate $23,734 after taxes–the 80% you get to keep–to fund future retirement income.

Might using a Roth IRA be better? No.

THE EXPERTS

The Experts are a group of industry and academic thought leaders who weigh in on topics covered in the The Journal Report.

The additional $5,000 in salary you wish to save for retirement would first be subject to 25% federal and 5% state income tax, leaving you $3,500 to put into your Roth IRA over the year. At the same 7% annual return for the next 30 years, you'd then have $20,767. True, this is all aftertax money; however, it's as much as 12% less than the after-tax amount of using your 401(k) instead.

(If you actually put $5,000 into your Roth, you also paid $2,143 more in taxes than if you had put $7,143 more into your 401(k).) This same rationale would lead to choosing a traditional–pretax–401(k) over the Roth version.

For any tax-nerds (like me) reading this, even if this additional pretax money in your 401(k) caused more of your future Social Security benefits to be taxable, it would take a quite unlikely alignment of the tax planets to fully wipe out this advantage.

Fortunately, you don't need a crystal ball about future tax rates to choose the more advantageous retirement saving strategy. Instead, it only requires a little tax planning savviness. If you're currently in the 25%+ tax bracket, keep piling those pretax contributions into your traditional, pretax 401(k) and forget the Roth–at least for now. It's certainly has its time and place but, for you, now is not it.

Read the latest **Investing in Funds & ETFs Report.**

Share this: http://on.wsj.com/1sei4t9

25% TAX BRACKET (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/25-TAX-BRACKET/)

401(K) CONTRIBUTIONS (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/401K-CONTRIBUTIONS/)

INVESTING IN FUNDS & ETFS (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/INVESTING-IN-FUNDS-ETFS/)

JONATHAN GUYTON (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/JONATHAN-GUYTON/)

ROTH IRA (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/ROTH-IRA/)

SAVING FOR RETIREMENT (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/SAVING-FOR-RETIREMENT/)

TAX BRACKET (HTTP://BLOGS.WSJ.COM/EXPERTS/TAG/TAX-BRACKET/)

Copyright 2014 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.