

## Key Elements of the U.S. Tax System

What types of nonemployer-sponsored retirement savings accounts are available?

TAXES AND RETIREMENT SAVINGS

**Q. What types of nonemployer-sponsored retirement savings accounts are available?**

**A. The two big types are traditional individual retirement accounts (IRAs) and Roth IRAs. The main difference: When the feds take their cut.**

### TRADITIONAL IRAS VERSUS ROTH IRAS

Workers and their spouses do not need their employers' help to save in tax-favored retirement accounts. They may open individual retirement accounts, which mostly come in two forms: traditional IRAs and Roth IRAs. (Other types of IRAs, such as SEP-IRAs and SIMPLE-IRAs, are only available through employers.) The primary difference is the timing of any tax on contributions or distributions.

Qualified contributions to traditional IRAs are excluded from tax and grow tax-free, but withdrawals are taxed. Contributions to Roth IRAs, conversely, are taxed in the year they are made. But account assets grow tax-free, and withdrawals after age 59½ are not taxed. Even though statutory contribution limits are the same for both traditional and Roth IRAs, the effective amount a saver can place in tax-preferred status is higher with a Roth IRA because the saver is contributing post-tax income.

As of tax year 2017, over 60 million taxpayers (or 29 percent) owned IRAs. About 48 million taxpayers (or 23 percent) held traditional IRAs, while nearly 20 million taxpayers (or 10 percent) held a Roth IRA. Some households owned both.

### THE FINE PRINT

These rules are a bit confusing. Taxpayers with income over a specified level, which varies with tax-filing status, may not contribute to a Roth IRA and in some cases may not deduct contributions to a traditional IRA. Nor may taxpayers who participate (or whose spouses participate) in employer-provided pensions deduct traditional IRA contributions if their income exceeds a specified limit.

For single taxpayers without access to an employer-sponsored pension, and for married couples in which neither spouse participates in such a pension plan, there are no income restrictions on the deductibility of traditional IRA contributions. A married taxpayer who does not participate in an employer-sponsored plan, but whose spouse does, may contribute the maximum statutory amount to an IRA, provided the couple's joint modified adjusted gross income does not exceed \$196,000 for 2020.

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### Data Sources

Internal Revenue Service. 2020. *SOI Tax Stats—Accumulation and Distribution of Individual Retirement Arrangements*. Tax Year 2017, Tables 2, 4, and 7.

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### Further Reading

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