



# WHICH IRA IS RIGHT FOR YOU?



*Saving for retirement in a self-directed Individual Retirement Account (IRA) comes with many advantages: access to a broad variety of investment options, tax benefits and the opportunity to consolidate your retirement savings. There are different types of IRAs available to you and each provides different benefits. The right IRA option for you will depend on your current income level, savings goals and retirement income needs. It also depends on whether you are saving in an IRA as an individual or a business owner – or both.*

*To help you and your financial advisor determine which IRA is right for you, STRATA Trust Company brings you this whitepaper to help explain the tax benefits and other important considerations for each type of IRA.*

## IRAs FOR INDIVIDUALS

Two types of IRAs are designed to help you save for retirement, without the involvement of an employer: a Traditional IRA and a Roth IRA. Both options provide tax-deferred investment earnings and the freedom to choose your own investments. But the tax benefits and eligibility requirements are quite different for Traditional and Roth IRAs. You may find that one type of IRA is more beneficial to you now, depending on your income and tax status, but in future years you may choose a different type of IRA. Some investors save in both types of IRAs to diversify the tax character of their retirement savings and take advantage of the different benefits each type of IRA has to offer.

### Traditional IRAs

The most common IRA is the Traditional IRA. To be eligible to contribute, you must have

earned income and you must be younger than age 70½. Contributions are optional and can vary in both amount and timing from year-to-year. For 2018, you may contribute up to \$5,500. If you are age 50 or over, you may make an additional “catch-up” contribution of \$1,000. Contributions to all Traditional and Roth IRAs are aggregated when calculating the annual contribution limit.

### Tax Deduction

One of the main incentives for making Traditional IRA contributions is the option to take a tax deduction for your contributions. A tax deduction will potentially lower the amount of tax you owe. If you think your tax rate now is higher than it will be when you retire, a Traditional IRA may be a good option for you. By taking a deduction now, you will avoid paying taxes on your retirement savings when your tax rate is high. Instead, you will pay taxes on your savings (contributions and earnings) as you take

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withdrawals from the IRA, presumably after you have retired and are in a lower tax bracket.

Traditional IRA 2018 Income Limit for Deduction	
Single	Under \$73,000
Married	Under \$121,000

You may take a tax deduction for your IRA contributions unless you (or your spouse) are participating in an employer’s retirement plan, such as a 401(k) plan, SEP or SIMPLE IRA plan. If you are participating in an employer plan, your IRA contribution will be deductible so long as your modified adjusted gross income does not exceed certain limits. These limits are adjusted periodically based on the cost-of-living. If you don’t qualify for a deduction, you may make a nondeductible contribution, which will be tax-free when you take it out of the IRA.

**Savings Consolidation**

The ability to consolidate your retirement savings into one tax-advantaged account is another important benefit of saving in an IRA. You can roll assets into your Traditional IRA from other Traditional IRAs as well as from 401(k) plans, 403(b) plans, governmental 457(b) plans and SIMPLE IRAs (after a two-

year holding period). Benefits of consolidating your retirement savings into a single account include:

- Having only one investment portfolio to manage
- Keeping track of only one account access portal and one set of login credentials
- Possibly reducing overall investment and account management fees
- Simplifying and coordinating your retirement income planning and payment strategy
- Streamlining your finances for your beneficiaries if you become unable to manage your investments or die before depleting your retirement savings



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## Considerations

Although the flexibility to take a distribution at any time is another prized benefit of IRAs, the money you take out of a Traditional IRA generally must be included in your taxable income for the year. In addition, a 10% early distribution tax generally applies to taxable distributions taken prior to age 59½. Then, once you turn age 70½, you will be required to take a minimum amount (“required minimum distribution” (RMD)) out of your IRA each year until the account balance is depleted.

### *Common candidates for Traditional IRAs are individuals who:*

- ✓ Are eligible to take a tax deduction for their contributions
- ✓ Believe they will be in a lower tax bracket in retirement
- ✓ Are not eligible to contribute to a Roth IRA
- ✓ Want to roll over assets from another retirement account and continue deferring taxation of their retirement savings and investment earnings

## Roth IRAs

A Roth IRA has some important differences when compared to Traditional IRAs.

- Funded with after-tax contributions – no tax deduction available
- No age 70½ limit for contributing to a Roth IRA – you can continue to fund your Roth IRA as long as you have sufficient earned income to support each year’s contribution
- Income limit applies – you must have income under a set limit to be eligible to contribute to a Roth IRA

## Tax-free Distributions

Contributing to a Roth IRA will not reduce your taxable income in the years you make contributions. Instead, the primary tax benefit occurs when you take withdrawals from your Roth IRA. Here’s how it works: You can withdraw the money you contributed at any time tax and penalty free because you paid the tax on those assets when you funded the Roth IRA. If you take a “qualified” distribution, the tax-deferred investment earnings in your Roth IRA will also be tax-free. This could be a significant amount of tax-free money. To take a qualified distribution, you must:

- Have had a Roth IRA for at least five years, and

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- Have a qualifying event – be age 59½ or older, disabled, deceased or taking a first-time homebuyer distribution

If you are in a low tax bracket now and think you will be paying tax at a higher rate in retirement, a Roth IRA may be appealing, especially if you anticipate significant growth in the value of your investments.

401(k), 403(b) or 457(b) plan, you may roll it over tax-free to a Roth IRA. You may also roll over your pre-tax money from an employer plan or a Traditional or SIMPLE IRA (after a two-year holding period) to a Roth IRA. This transaction “converts” pre-tax retirement savings to after-tax Roth savings. The conversion amount is included in taxable income in the year it is rolled over. Once the assets are in the Roth IRA, they may be distributed tax-free.

Roth IRA 2018 Income Limit for Eligibility	
Single	Under \$135,000
Married	Under \$199,000

**No Mandatory Distributions**

Roth IRAs are not subject to the age 70½ RMD rules while you are alive. You can allow your Roth IRA assets to grow without having to draw down the balance each year after reaching age 70½. You may pass the assets on to your IRA beneficiaries tax-free. This makes Roth IRAs a popular vehicle in retirement income and estate planning strategies.

**Rollover Options**

If you have a designated Roth account in a

*Common candidates for Roth IRAs are individuals who:*

- ✔ Want to pay tax at today’s rates (vs. future unknown rates)
- ✔ May need access to tax and penalty-free assets before retirement
- ✔ Have significant time to accumulate tax-free investment earnings
- ✔ Would like to pass tax-free retirement assets to heirs

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## Traditional and Roth IRA Comparison

	TRADITIONAL IRA	ROTH IRA
Eligibility to Contribute	Under age 70½ & earned income	Earned income within limits
Contribution Limit (for 2018)	\$5,500 + \$1,000 catch-up contribution if age 50 or older	\$5,500 + \$1,000 catch-up contribution if age 50 or older
Contribution Taxation	Deductible (if participating in an employer plan, must have income within limits)	Never deductible
Distribution Taxation	Taxable, unless nondeductible contributions or after-tax rollovers from employer plans; 10% early distribution tax applies to taxable savings & earnings	Contributions always tax-free, earnings tax-free if qualified distribution; 10% early distribution tax applies only to taxable earnings (non-qualified distributions)
Distribution Timing	Withdrawals permitted anytime; RMD rules apply beginning at age 70½	Withdrawals permitted anytime; RMD rules apply only after IRA owner's death

### *You Do Not Have to Pick Just One*

The major difference between Traditional and Roth IRAs is the timing of the tax benefit. With a traditional IRA you delay paying taxes on your savings until you withdraw funds in retirement. With a Roth IRA, you pay the taxes up front and enjoy tax-free distributions in retirement. The decision as to which IRA is right for you comes down to when you think it would be most beneficial to pay taxes. But you do not have to pick just one. You can save in both types of IRAs if you meet the eligibility requirements. Just as you diversify your investment portfolio, you may want to consider diversifying the tax status of your IRA savings.

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## FOR BUSINESS OWNERS

As a business owner, you may sponsor an IRA-based savings plan to help you and your employees save for retirement. Contributions are tax-deductible by the business, and small businesses may qualify for a tax credit for start-up costs. IRA-based retirement plans are easy to administer and are generally less expensive than other types of retirement plans, such as a 401(k) plan. Other advantages that IRA plans have over other types of employer plans include:

- No annual plan return (e.g., Form 5500)
- No non-discrimination testing
- No fiduciary risk for investments
- No ERISA bonding requirements

The two most common types of IRA-based employer plans are the SEP plan and the SIMPLE IRA plan.

### Simplified Employee Pension (SEP) Plan

The SEP plan is the easiest of all retirement plans for self-employed and small business owners to establish and operate. The employer adopts the plan and then makes contributions to a separate IRA for each eligible employee, if any, including the business owner.

### Employer Responsibilities

The employer has few administrative requirements and costs with a SEP plan. The employer's responsibilities are limited to:

- Signing a SEP plan document to establish the plan
- Choosing employee eligibility requirements and a formula for allocating contributions
- Depositing contributions into employees' Traditional IRAs
- Notifying employees when a SEP contribution is made

### Contributions

Under a SEP plan, employers may choose whether to contribute and how much to contribute each year. The annual contribution limit is 25% of an employee's compensation or \$55,000 (for 2018), whichever amount is smaller. Although employees are not allowed to make additional SEP contributions, they may make their own annual Traditional or Roth IRA contributions, if they meet the eligibility requirements for IRA contributions.

### Distributions & Taxation

Once SEP plan assets are deposited into the IRA, the Traditional IRAs rules apply, including the Traditional IRA distribution and taxation rules.

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### Savings Incentive Match (SIMPLE) IRA Plans

With a SIMPLE IRA plan, employers can provide a salary deferral arrangement similar to a 401(k) plan for their employees, but with far simpler administrative requirements. SIMPLE IRA plans are only available to small employers who have no more than 100 employees who earned more than \$5,000 in the preceding year. SIMPLE IRA plans have lower contribution limits than 401(k) plans and require employer contributions.

### Employer Responsibilities

As with a SEP plan, a SIMPLE IRA plan is established when the employer signs a plan document with a financial institution. Employee eligibility requirements and the employer contribution must be selected at this time. The employer also must make sure that employee deferrals and employer contributions are deposited timely and that the proper notices are provided to employees each year.

### Contributions

An employee who chooses to participate in a SIMPLE IRA plan must establish a SIMPLE IRA to receive deferrals and employer contributions and must complete a salary reduction agreement specifying the portion of their compensation they wish to contribute to the plan. For 2018, employees may defer up to \$12,500, as well as an additional \$3,000 catch-up contribution starting in the year the employee turns age 50.

Employer contributions may be either a

- Matching contribution – dollar-for-dollar up to 3% of compensation for employees who are deferring into their SIMPLE IRA, or
- Nonelective contribution – equal to 2% of compensation, for all eligible employees whether they defer or not.

### Distributions & Taxation

The distribution and taxation rules for SIMPLE IRAs are similar to those for traditional IRAs, except SIMPLE IRA owners generally must wait for two years from the date of the initial contribution under the plan to consolidate the SIMPLE IRA assets with a Traditional IRA or employer plan. The 10% early distribution tax that applies to taxable distributions prior to age 59½ increases to 25% for the first two years of an employee's participation in the SIMPLE IRA plan.

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## SEP and SIMPLE IRA Plan Comparison

	SEP PLAN	SIMPLE IRA PLAN
Employer Eligibility	Any Employer	Employer with 100 or fewer employees; does not maintain another plan
Maximum employee eligibility requirements	Age 21, employed by the employer for 3 of the last 5 years & compensation of \$600 for 2018	Earned income of at least \$5,000 in any prior 2 years & expected to earn at least \$5,000 in current year
Contributors to the Plan	Employer only	Employee & employer
Contribution Limits (for 2018)	25% of employee's compensation up to \$55,000; employer can vary contribution amount each year	Employee can defer up to \$12,000 (+ \$3,000 if age 50 or older); employer must make 3% matching contribution or 2% nonelective contribution
Distribution Taxation	Subject to income taxes & 10% early distribution tax	Subject to income taxes & 10% early distribution tax (25% in first 2 years)
Distribution Timing	Withdrawals permitted anytime; RMD rules apply	Withdrawals permitted anytime; RMD rules apply

### You Can Only Pick One

Although SEP and SIMPLE IRA plans are easy to establish and maintain, each type of plan has different features and employers should evaluate which plan is the best fit for their retirement savings and business needs. An employer who maintains a SIMPLE IRA plan cannot maintain any other plan during the same calendar year.

***For questions about establishing a Traditional or Roth IRA, or a SEP or SIMPLE IRA Employer plan, please contact us.***

***For more information, visit [www.StrataTrust.com](http://www.StrataTrust.com)***

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## ABOUT US



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STRATA Trust Company has quickly catapulted to become a premier national custodian for alternative assets and non-exchange traded investments in self-directed IRAs. Formerly known as Self Directed IRA Services, Inc., STRATA has been helping investors use their retirement account funds to invest since 2008. STRATA currently serves over 33,000 individuals nationwide with over \$1.8 billion in assets under custody.

With offices in Waco and Austin, Texas, our team's vast experience in handling the details and complexities that real estate transactions require is unrivaled. Our seasoned team's experience in the custody of alternative assets spans over 350 years. With a well-established reputation for honesty and integrity, STRATA is committed to delivering responsive, flexible and innovative solutions.

At STRATA, we work to ensure that the highest standards for safety and soundness are met. As a subsidiary of Horizon Bank, SSB, STRATA is a Texas-chartered trust company regulated by the Texas Department of Banking, which has long set the benchmark among state banking regulators. Strict controls are in place to ensure the safety of uninvested cash, and independent auditors are retained to conduct regular audits of our operations.

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