IRA Insights

Another way to diversify

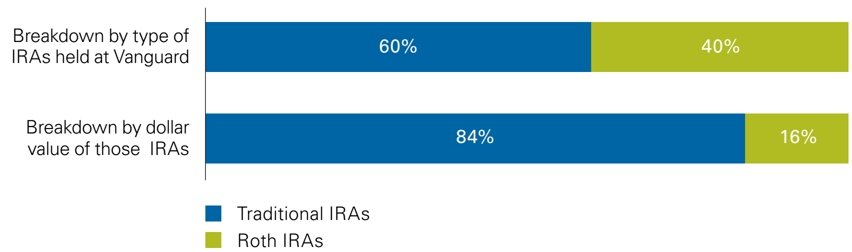
Vanguard research | April 2016

When investing for retirement, try to have some degree of tax diversification

Investors can benefit from having different types of retirement accounts. Roth IRA contributions, unlike those of traditional IRAs, offer no immediate tax deduction but provide tax-free earnings and withdrawals. Savvy retirees can withdraw from traditional IRAs when in low tax brackets and Roth IRAs when tax rates are higher.

Traditional IRAs have larger balances and are more numerous than Roth IRAs. They have been around much longer and get large inflows from 401(k) rollovers.

Investors could benefit from having more money in Roth IRAs



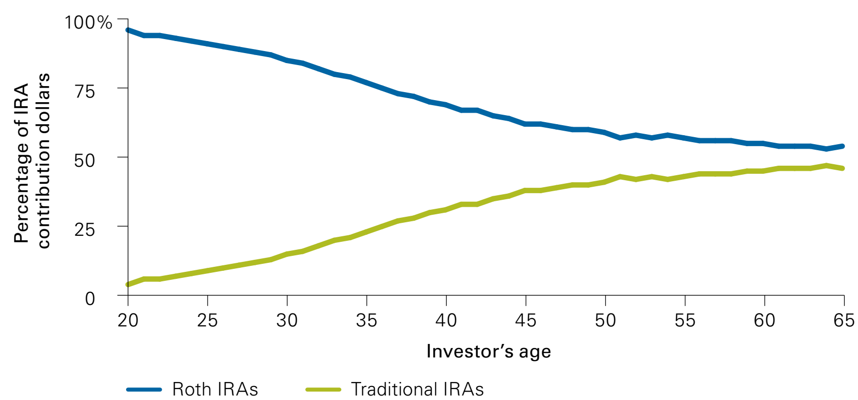
Notes: Sample consists of all Vanguard traditional and Roth IRAs as of December 31, 2015. Traditional IRA category includes contributory and rollover IRAs but not SEP-, SIMPLE, or inherited IRAs.
Source: Vanguard.

New contributions are largely going into Roth IRAs

In 2015, more than $2 of every $3 contributed to a Vanguard IRA went into a Roth. Traditional wisdom suggests that younger investors with lower incomes prefer Roth IRAs, while higher-income older investors prefer the immediate tax deduction from a traditional IRA contribution.

The contribution trend by age supports this view, but even at older ages, a majority of contributions went into Roth IRAs. This trend is helping to increase investors' overall tax diversification.

Investors favor Roth IRAs for new contributions



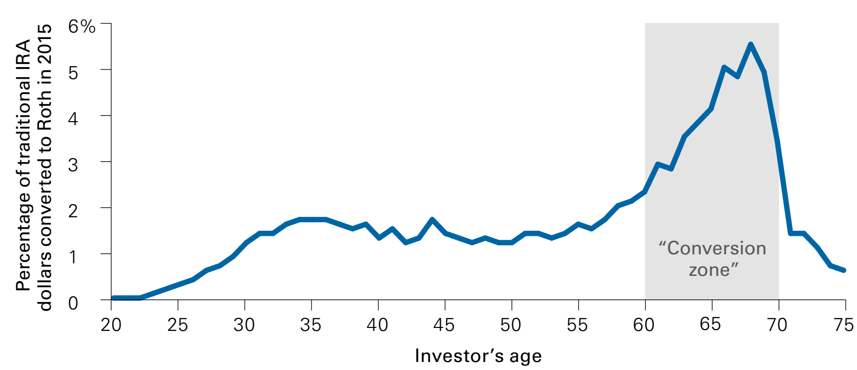
Notes: Sample consists of all Vanguard traditional and Roth IRA contributions made in calendar year 2015. Traditional IRA category includes contributory and rollover IRAs but not SEP-, SIMPLE, or inherited IRAs.
Source: Vanguard.

Another way to increase tax diversification: Roth conversions

New contributions are not the only way to increase Roth holdings. Investors who retire with traditional IRAs sometimes take advantage of their lower tax rates to make partial Roth conversions before age 70½, when Required Minimum Distributions (RMDs) begin. Roth IRAs are not subject to RMDs, so they can keep growing tax-free throughout retirement and be withdrawn tax-free as needed.

Investors aged 60–70 were responsible for a large percentage of traditional IRA money that was converted to Roth in 2015.

Taking advantage of lower tax rates in "the conversion zone"



Note: Sample consists of all conversions from Vanguard traditional IRAs to Vanguard Roth IRAs made in calendar year 2015.
Source: Vanguard.

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All investing is subject to risk, including the possible loss of the money you invest. We recommend that you consult a tax or financial advisor about your individual situation.

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