What Is a Roth IRA?

Roth IRAs are tax-favored financial vehicles that enable investors to save money for retirement. They differ from traditional IRAs in that taxpayers cannot deduct contributions made to a Roth. However, qualified Roth IRA distributions in retirement are free of federal income tax and aren't included in a taxpayer's gross income. That can be advantageous, especially if the account owner is in a higher tax bracket in retirement or taxes are higher in the future.

A Roth IRA is subject to the same contribution limits as a traditional IRA ($5,500 in 2015). (The maximum combined annual contribution an individual can make to traditional and Roth IRAs is $5,500 in 2015.) Special "catch-up" contributions enable those nearing retirement (age 50 and older) to save at an accelerated rate by contributing $1,000 more than the regular annual limits.

Another way in which Roth IRAs can be advantageous is that investors can contribute to a Roth after age 70½ as long as they have earned income, and they don't have to begin taking mandatory distributions due to age, as they do with traditional IRAs; however, beneficiaries of Roth IRAs must take mandatory distributions.

Roth IRA withdrawals of contributions (not earnings) can be made at any time and for any reason; they are tax-free and not subject to the 10% federal income tax penalty for early withdrawals. In order to make a qualified tax-free and penalty-free distribution of earnings, the account must meet the five-year holding requirement and you must be age 59½ or older. Otherwise, these withdrawals are subject to the 10% federal income tax penalty (with certain exceptions including death, disability, unreimbursed medical expenses in excess of 10% of adjusted gross income, higher-education expenses, and for the purchase of a first home ($10,000 lifetime cap).* However, these withdrawals would be subject to ordinary income tax.

Keep in mind that even though qualified Roth IRA distributions are free of federal income tax, they may be subject to state and/or local income taxes. Eligibility to contribute to a Roth IRA phases out for taxpayers with higher incomes.

If you're looking for a retirement savings vehicle with some distinct tax advantages, the Roth IRA could be appropriate for you.

* Individuals age 65 and older can continue to claim qualified medical expenses that surpass 7.5% of AGI through 2016.