

# TRADITIONAL IRA VS. ROTH IRA: THE INCENTIVES OF TAX BENEFITS AND CONSUMER CHOICES

*Suresh C. Srivastava, College of Business and Public Policy, University of Alaska Anchorage  
3211 Providence Dr., Anchorage, Alaska 99508, (907) 786 4148, [afscs@uaa.alaska.edu](mailto:afscs@uaa.alaska.edu)*

*Yong Cao, College of Business and Public Policy, University of Alaska Anchorage  
3211 Providence Dr., Anchorage, Alaska 99508, (907) 786 4176, [afyc@uaa.alaska.edu](mailto:afyc@uaa.alaska.edu)*

## ABSTRACT

Traditional IRAs continues to be very popular over Roth IRAs among individual investors despite the deferred tax advantage of the Roth IRAs. The popularity of traditional is due to a number of behavioral reasons and expectations. Investors assign a greater value to the immediate tax benefit under traditional IRA then the deferred tax benefit of Roth IRA. In this paper, we examine the investment portfolio of a large number of individuals. Our regression model allows for a number of behavioral and socio-economic factors in assessing the preference of traditional IRA over Roth IRA.

## INTRODUCTION

Congressional Budget Office recently reported that participation in IRAs for 2000 was split approximately evenly between Roth IRAs and traditional IRAs (See “Utilization of Tax incentives for Retirement Savings: An Update,” Congressional Budget Office, February 2006). This result is somewhat surprising. Our cash flow analysis indicates that the present value of the deferred tax saving from Roth IRA exceed the current tax savings from traditional IRAs. This result is robust for different investment horizons and investment options, such as a portfolio of treasury bonds, a balanced portfolio of stocks and bonds or a portfolio of stocks.

The continued popularity of tradition IRAs could be due to behavioral and expectation factors. Important among them are:

- a. investor’s inertia of continuing to invest in traditional IRA.
- b. lack of comprehensive knowledge about Roth IRA.
- c. belief that the marginal tax rate in retirement will be lower than the current tax rate.
- d. strong recommendation by tax preparing professionals for a greater refund.
- e. unawareness that withdrawal from traditional IRA may result in higher tax bracket.

We examine the investment portfolio of a large number of individuals using a proprietary data obtained from a financial institution. Our regression model allows for a number of the above factors in assessing the continued preference of traditional IRA over Roth IRA.