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Traditional IRA & Dividends

There are many benefits to owning dividend paying stocks. Reinvesting dividends in your portfolio can be one of the best ways to increase asset appreciation. However, despite the many advantages of dividends, they can be a tax trap when it comes to distributions in a traditional IRA.

In a regular investment account, the dividends and capital gains you earn benefit from capital gains tax treatment. This means these earnings could be taxed at a lower rate (from 0% to 20% depending on your income level). For example, if you are in the 10% or 15% tax bracket, you would pay 0% taxes on dividends and long-term capital gains. Those in the 25% to 35% tax bracket would pay just 15% on dividends and capital gains. Those in the highest tax bracket, 39.6%, would pay just 20% on dividends and capital gains.

Most money withdrawn from a traditional IRA is taxed at your current income tax rate, which could be as high as 39.6%. Any capital gains on the earnings in your IRA account do not benefit from lower capital gains tax treatment; they are taxed at the same rate as regular income. If you have multiple types of accounts, you may want to properly allocate the different income producing securities to the accounts that will possess the best tax relief.