RETIREMENT RISK ADVISORS

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# Roth 401(K)

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# Risk Management & Strategy: Roth 401(K)

Most CPAs approach retirement age with an abundance in their traditional 401(k)s and Social Security as their retirement plan. But these alone will not last 30-40 years like retirement typically does. With risks such as longevity, inflation, and increased tax rates, more prep work is needed to get through retirement successfully and happily. In this month's newsletter, we will cover the Roth 401(k) as a potential strategy for your retirement.

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# A Roth 401(k) Overview

A Roth 401(k) is a retirement savings plan that combines the features of a traditional 401(k) and a Roth IRA. It was introduced in 2006 as part of the Pension Protection Act to provide workers with more options to save for retirement. Like a traditional 401(k), contributions are made on a pre-tax basis, but unlike a traditional 401(k), contributions to a Roth 401(k) are made with after-tax dollars, which means that contributions are not tax-deductible.

The Roth 401(k) offers several advantages over a traditional 401(k) and Roth IRA. First, contributions to a Roth 401(k) grow tax-free, which means that the money in the account can be withdrawn without paying any taxes on the earnings. This can be particularly advantageous for younger workers who have many years of growth ahead of them. In addition, unlike a Roth IRA, there are no income limits for contributing to a Roth 401(k), which means that high-income earners can take advantage of this retirement savings vehicle.

Another advantage of the Roth 401(k) is that it provides flexibility in retirement. Withdrawals from a traditional 401(k) are subject to income tax, but withdrawals from a Roth 401(k) are not. This means that retirees can withdraw money from their Roth 401(k) without worrying about the impact on their income taxes. In addition, there are no required minimum distributions (RMDs) for Roth 401(k) accounts, which means that retirees can leave the money in the account to continue growing tax-free for as long as they wish.

Despite its advantages, the Roth 401(k) may not be the best choice for everyone. One consideration is the current tax rate compared to the expected tax rate in retirement. If a worker expects to be in a higher tax bracket in retirement, a traditional 401(k) may be a better choice. On the other hand, if a worker expects to be in a lower tax bracket in retirement, a Roth 401(k) may be a better choice.

Another consideration is employer matching contributions. Many employers offer matching contributions to 401(k) plans, but these contributions are made on a pre-tax basis. This means that if an employer contributes to a worker's Roth 401(k), the contributions will be taxed when withdrawn. In this case, it may be better for the worker to contribute to a traditional 401(k) to take advantage of the employer match and then consider contributing to a Roth IRA separately.

# Determining the Pros & Cons of a Roth 401(k)


A Roth 401(k) is not for everyone but knowing the key advantages and disadvantages of this type of retirement account can help determine if it would benefit you or not.

## Advantages:

1. **Tax-free withdrawals:** One of the biggest advantages of a Roth 401(k) is that withdrawals are tax-free in retirement. This means that you won't have to pay any taxes on the money you withdraw from your account. This can be a significant advantage, especially if you expect to be in a higher tax bracket in retirement than you are now.

2. **Tax-free growth:** Another advantage of a Roth 401(k) is that the money in your account grows tax-free. This means that you won't have to pay any taxes on the earnings

in your account, which can help your money grow faster over time.

3. **No required minimum distributions (RMDs):** Unlike traditional 401(k) accounts, Roth 401(k) accounts are not subject to required minimum distributions (RMDs). This means that you can keep your money in your account for as long as you want and let it continue to grow tax-free.

4. **No income limits:** Unlike Roth IRAs, there are no income limits for contributing to a Roth 401(k). This means that high-income earners can still take advantage of the tax-free growth and tax-free withdrawals offered by a Roth 401(k).

5. **Diversification:**

***"Contributing to a Roth 401(k) can help diversify your retirement portfolio."***

By having both traditional and Roth accounts, you can have more flexibility in retirement and potentially reduce your tax liability.

6. **Estate planning:** A Roth 401(k) can also be a useful tool for estate planning. Since withdrawals are tax-free, you can leave more money to your heirs without worrying about the tax implications.

## Disadvantages:

1. **No tax deduction:** Unlike traditional 401(k) contributions, Roth 401(k) contributions are made with after-tax dollars. This means that you won't receive a tax deduction for contributions made to your Roth 401(k) account.

2. **Lower contributions:** The maximum annual contribution to a Roth 401(k) is the same as for a traditional 401(k). However, since Roth 401(k) contributions are made with after-tax dollars, the amount of money you can contribute on an after-tax basis may be lower than what you can contribute on a pre-tax basis.

3. **Tax implications:** Although Roth 401(k) contributions and withdrawals are tax-free, the tax implications of making the switch from traditional 401(k) to Roth 401(k) contributions can be complex. You'll need to consider your current tax rate, your expected tax rate in retirement, and any tax implications of converting your traditional 401(k) contributions to Roth 401(k) contributions.

4. **Employer match:** If your employer offers a matching contribution to your 401(k) account, it's important to consider how these contributions will be treated in a Roth 401(k). Since employer contributions are made on a pre-tax basis, they will be taxed when withdrawn from a Roth 401(k).

5. **Lower income in retirement:** If you expect your income to be lower in retirement than it is now, a traditional 401(k) may be a better choice. Since traditional 401(k) contributions are made with pre-tax dollars, you'll receive a tax deduction now and pay taxes on withdrawals in retirement when your income may be lower.

# Traditional v. Roth 401(k): Which Is Right for You?

## Traditional 401(k):

A traditional 401(k) is a retirement savings plan offered by many employers. With a traditional 401(k), contributions are made with pre-tax dollars, which means that the money you contribute to your account is deducted from your taxable income in the year it is contributed. The money in your account grows tax-free until you withdraw it in retirement, at which point it is taxed as income. One of the main advantages of a traditional 401(k) is that it can lower your taxable income now, which can be especially helpful if you are in a higher tax bracket. Additionally, if your employer offers matching contributions, these contributions are typically made on a pre-tax basis and grow tax-free until withdrawn.

However, there are some drawbacks to a traditional 401(k). Since withdrawals are taxed as income, the amount of money you have available in retirement may be less than you expected, especially if your tax rate increases in retirement. Additionally, traditional 401(k) accounts are subject to required minimum distributions (RMDs) starting at age 72, which means you must withdraw a minimum amount each year or face penalties.

## Roth 401(k):

A Roth 401(k) is similar to a traditional 401(k), but with some key differences. With a Roth 401(k), contributions are made with after-tax dollars, which means that you do not receive a tax deduction in the year the contribution is made. However, the money in your account grows tax-free, and withdrawals in retirement are also tax-free.

One of the main advantages of a Roth 401(k) is that you can withdraw your money in retirement tax-free, which can be especially helpful if you expect your tax rate to be higher in retirement. Additionally, Roth 401(k) accounts are not subject to required minimum distributions (RMDs), which means you can leave your money in the account to grow tax-free for as long as you want.

However, there are also some drawbacks to a Roth 401(k). Since contributions are made with after-tax dollars, your contributions will not lower your taxable income now. Additionally, if your employer offers matching contributions, these contributions are typically made on a pre-tax basis and will be taxed when withdrawn from a Roth 401(k).


The answer depends on your individual financial situation. If you expect your tax rate to be lower in retirement than it is now, a traditional 401(k) may be the better choice. However, if you expect your tax rate to be higher in retirement or want the flexibility to withdraw money tax-free, a Roth 401(k) may be the better option.

Additionally, you may want to consider contributing to both types of accounts to create a diversified retirement portfolio. This can help you manage your tax liability in retirement and provide more flexibility when it comes to withdrawals.

## March Webinars

3/13 – Shopping for Long-Term Care Insurance & Your Nursing Home

3/16 – Medicare and You

3/18 – Getting Safely Through Retirement: A New Paradigm in Retirement Planning

3/21 – Inflation and the Rising Cost of Health Care in Retirement

3/22 – Getting Safely Through Retirement: A New Paradigm in Retirement Planning

3/22 – How to Recession Proof Your Retirement

3/24 – The Top 15 Reasons Why People Run Out of Money in Retirement

3/28 – How to Protect Your Retirement Assets Before the Next Crash

3/29 – Getting Safely Through Retirement: A New Paradigm in Retirement Planning

3/30 – Evolving Retirement Law: The Challenges, The Changes & Your Choices

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## Contact

(855) 491-0400

support@retirementriskadvisors.com
www.retirementriskadvisors.com

1309 Coffeen Avenue, Suite 3851
Sheridan, WY 82801

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