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Let's Talk About Your Employer-Sponsored 401(k)

Roth or Traditional?

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When the time comes to retire, you want to be comfortable with your financial situation. Choosing to save for retirement is easy; however, choosing *how* to save can be difficult. You have multiple retirement vehicles to choose from, such as a traditional IRA, Roth IRA, or a 401(k) plan. All offer different advantages.

A traditional IRA, like a 401(k), is a tax-deferred savings account, which allows you to contribute your money as pre-tax dollars. Moreover, these pre-tax dollars may be deducted from your taxable income. You may be familiar with Roth IRAs. They differ from traditional IRAs, primarily because your contributions are after-tax dollars, which enables you to withdraw your money tax-free in retirement.

But what about a Roth 401(k)? Increasingly, employer-sponsored retirement plans are offering Roth options in their 401(k) plans. According to a May 17, 2019, article in the online version of *The Wall Street Journal*, "When to Save for Retirement in a Roth 401(k)," 71 percent of employer plans administered by Vanguard offered Roth options in 2018. For many people, choosing a Roth is the best option.

If your employer offers both Roth and traditional 401(k) plans, then the most compelling reason to select a Roth, especially for young investors, is because the earnings grow tax-deferred and will be collected tax-free. Alternatively, a traditional 401(k) is funded with pre-tax dollars and thus the withdrawals in retirement, including earnings, will be taxed.

One argument for a traditional 401(k) claims you contribute pre-tax dollars during your work life when you have more significant earnings, thus are in a higher tax bracket. Then in retirement, you no longer have that level of earnings, so you are in a lower tax bracket when you ultimately have to pay the tax on the funds at withdrawal. These higher contributions, coupled with lower taxes on withdrawals, result in more retirement dollars. But you are kicking the tax can down the road. Who can predict what tax brackets will look like when you retire? Tax brackets change over time, which may result in either a lower or higher overall payout. Furthermore, if you are early in your career and anticipate your income increasing, it may prove advantageous to make use of your lower tax bracket now.

A second argument for a Roth over a traditional 401(k): If you need to withdraw funds along the way, you can do so tax-free from your Roth account — though some Roth plans do include an early withdrawal penalty if the withdrawal is in excess of your contribution limit.

Why not open a Roth IRA instead of a Roth 401(k)? A Roth 401(k) almost always trumps an IRA, even if your employer does not offer a matching contribution, because of the maximum contribution amounts. In 2019, 401(k)s allowed contributions of $19,000 for employees under the age of 50 and $25,000 for employees 50 and older, as compared to $6,000 and $7,000 respectively for an IRA. As well, Roth IRA contribution maximums are phased out at certain income levels, starting at $122,000 for single tax filers and $193,000 for married, filing jointly.

Make sure to talk o an advisor who understands your tax and overall financial information, so you can decide how to split your contributions between the two. You may hedge your bets and contribute to both, within the contribution limitations. Designating contributions to the Roth 401(k) may be advantageous for you, and your employer's match will automatically go to the traditional part of the plan since they are pre-tax dollars. This allocation strategy is an effective way of balancing your retirement savings by allowing you to receive the advantages of both plans, and ultimately, increasing your retirement income.

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Genevieve is a Financial Advisor in the Stuart, Florida, office of HBKS®, working with Stephen Schramm and his team. She brings more than 10 years of public accounting experience working with clients in a number of industries. She is also a Manager for the firm partner HBK CPAs & Consultants. She holds the designations of Certified Public Accountant, CERTIFIED FINANCIAL PLANNER™ and Certified Fraud Examiner.