Roth 401(k): Is It Right for You?

Should you make contributions to your retirement account with pre-tax dollars or after-tax dollars, known as Roth contributions – or a combination of both? Only you can decide what is right for you.

When you choose to make Roth contributions, they are subject to federal and state income tax – like regular pay – at the time they are contributed to the plan. However, the earnings on your Roth contributions will be tax-free at withdrawal if you take a qualified Roth distribution. Pre-tax contributions and earnings, on the other hand, are generally taxed upon withdrawal.

	Pre-Tax Contributions	Roth Contributions
Contributions	Not taxed until withdrawn	Taxed at time of contribution
Earnings	Taxed when withdrawn	Tax-free (if qualified)

So, which is better? Both can give you a tax advantage, but depending on your situation and your expectations for your future, you may decide that one is preferable to the other. Here are some factors to consider:

- **Future Tax Rates** – If you think that increases in tax rates are inevitable, then you may want to contribute with after-tax dollars now rather than pay higher taxes on your retirement savings in the future.
- **Tax Bracket at Retirement** – If you believe you will be in a higher tax bracket when you retire, consider paying taxes now by choosing Roth after-tax contributions.
- **Years Until Retirement** – If you are far away from retirement, any earnings (interest on your contributions) have more time to grow. Qualified Roth distributions on earnings are tax free, and that may compensate for the taxes you pay on your contributions.
- **Estimated Age at Retirement** – The tax advantages of Roth contributions currently apply to withdrawals made only after a retiree reaches age 59½, so if you think you might withdraw funds earlier than age 59½, then making pre-tax contributions may be a better strategy.
- **Adjusted Gross Income (AGI)** – Even if your income level prevents you from contributing to a Roth IRA, you can make Roth contributions through the retirement plan.
- **Taxes on Social Security Benefits** – If you would prefer to avoid paying taxes on your Social Security benefits and you are at least five years away from retirement, you might consider Roth contributions. Qualified Roth withdrawals are excluded from taxable income when calculating taxes on Social Security benefits.
- **Estate Planning** – If you want to leave money to children or relatives that they can withdraw tax free, you might consider Roth contributions.

Try the Roth Analyzer, an easy calculator to help you compare saving with pre-tax, after-tax or both.

What Is Right for You? The decision regarding pre-tax contributions versus Roth contributions – or a combination of both – is a complicated one that is best made with the help of a personal financial and tax adviser. Work with your adviser to compare your current status with future projections on such factors as tax deductions, your income and your tax rate. These and other factors will affect the amount of taxes you pay on your contribution dollars.