

HERITAGE BENEFITS

What is a Roth 401k?

A Roth 401k is a type of 401k that allows you to make after-tax contributions and then get tax-free withdrawals when you retire. A traditional 401k, on the other hand, allows pre-tax contributions, then your withdrawals in retirement are taxable.

MORE MONEY NOW VS LATER

It can be hard to turn your back on those attributes, but is a Roth 401k suitable for you? Here are the factors to consider.

- ✓ It may cost you more on the front end to use a Roth 401k. Contributions to a Roth 401k can hit your budget harder today because an after-tax contribution takes a bigger bite out of your paycheck than a pretax contribution to a traditional 401k.
- ✓ The Roth account can be more valuable in retirement. That's because when you pull a dollar out of that account, you get to put that entire dollar in your pocket. When you pull a dollar out of a traditional 401k, you can keep only the balance after paying taxes on the distribution.

YOUR TAX RATES NOW VS LATER

If you can commit to investing the tax savings from a traditional 401k contribution, this debate becomes largely about comparing your tax bracket now versus in the future.

If your tax rate is low now and you expect it to be higher in retirement:

- ✓ You may want to make contributions with after-tax dollars – which you can do with a Roth 401k,
- ✓ Then you won't pay taxes at that higher rate when you take qualified distributions in retirement.
- ✓ This scenario of lower rate now, higher rate later can affect many workers, especially those early in their careers. Your income and standard of living likely will increase over time, so you may want to draw more money in retirement than you're earning now.
- ✓ There's also the possibility of across-the-board legislative tax increases; current tax rates are low when put in historical context.

If your tax rate is higher now than you expect it to be in retirement:

- ✓ It can make sense to contribute to a traditional pre-tax 401k,
- ✓ Then you'll pay taxes at that expected lower tax rate when taking distributions in retirement.
- ✓ If you're closer to retirement, you may have a better idea of how your tax rate may change in those years. Many retirees live frugally, resulting in a lower tax burden.