

How Roth Retirement Accounts Can Work For You

By Nanci Hellmich

Many people are aware of the benefits of using a traditional 401(k) or an individual retirement account (IRA) to save or invest money for their retirement, but they may have either not heard ofâ??or possibly overlookedâ??the advantages of Roth savings opportunities within their employersâ?? retirement plans.

â??Clients often ask me what the benefits of using a Roth in a retirement plan are. â??Is it right for me? Should I put my savings into the traditional pre-tax portion of my 401(k) or into the Roth portion?â??â?• says Todd Jones, a CAPTRUST financial advisor in Raleigh, North Carolina.

Jones tells them that there are some very good reasons to consider using the Roth feature within retirement accounts, but that they should evaluate the pros and cons.

Unlike Roth IRAs that carry income limits to prevent high wage earners from participating, Roth 401(k) and 403(b)s have no income limits. â??This opens up a fantastic tax-free savings opportunity through their employer-sponsored retirement programs, assuming it has a Roth feature within the plan,â?• Jones says.

With a traditional 401(k) or 403(b), employees are allowed to save using pretax dollars. â??That means they donâ??t have to pay income tax on the money before itâ??s saved, so essentially theyâ??re lowering their tax bill at that time,â?• Jones says. â??But, eventually, they will have to pay

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federal and, typically, state income taxes on both their savings and earnings when the funds are withdrawn from the account.â?•

Currently, employees can make contributions of $18,000 a year, plus an additional $6,000 for those who are age 50 or older.

Many people benefit from the current yearâ??s tax break on this kind of savings. For instance, if a person makes $75,000 a year and puts 10 percent of her incomeâ??or $7,500â??into her retirement plan at work, she might save about $2,500 in taxes, Jones says.

More employersâ?? plans are starting to offer employees Roth accounts, and there are some benefits to these retirement savings plans, Jones says. â??Employees pay taxes on the money before it goes into the account, but their investments and earnings grow tax free, so when they take the money out in retirement, they donâ??t have to pay any taxes on it.â?•

There are several advantages to using the Roth retirement accounts for some folks, he says. For instance, a Roth may be a good option for:

- **Younger workers.** People who are early in their careers and, subsequently, not earning a lot of money just yet. Assuming they have a bright future and expect their income to grow throughout their career, the Roth may make a great deal of sense. They donâ??t necessarily need the tax break that theyâ??d get from a traditional 401(k) account now, but a Roth account may be helpful in the future when they are in a higher tax bracket. â??Later in life, theyâ??ll be able to withdraw money without paying taxes on it when their tax rate is higher than it has ever been,â?• Jones says.
- **Tax pessimists.** Some people think tax rates will go up because of a variety of reasons, including the governmentâ??s initiative to balance the budget and fund social programs, Jones says. If thatâ??s what you believe, the Roth may make sense. If you put after-tax money into a Roth now, and tax rates go up later, you will have paid taxes on your income at a lower rate while letting your investments grow tax free, he says.
- **High earners.** Those earning high salaries and paying income taxes in the highest income tax brackets may also be interested. Saving $18,000 in a traditional 401(k) may not provide much of a tax benefit for them today â??because their tax bills are huge anyway,â?• Jones says. However, it may be helpful to have money in â??a tax-free bucketâ?• later in life. In essence, high wage earners may choose to â??take their lumpsâ?• today from a tax standpoint in exchange for the benefit of creating a tax-free nest egg that can be accessed down the road, he says.

Employees who have access to an employer-sponsored retirement plan with both traditional 401(k) and Roth 401(k) features may choose to make contributions to either a traditional pre-tax account or a Roth account, or a combination of the two. Regardless, the total amount saved to these accounts canâ??t exceed the annual amount allowed of $18,000 a year, plus an additional $6,000 for those age 50 or older, Jones says. â??You can split the money up, but you canâ??t go over the aggregate limit.â?•

When companies make profit-sharing contributions into a plan or offer matches, the money is deposited into the pretax part of the 401(k) or 403(b)â??not the Roth component. As a consequence, most employees will already have a nest egg growing tax deferred that will eventually be subject to taxes and required minimum distributions. So, it could make sense for some employees to begin deferring their own money into a Roth account.

Some people choose to put a percentage of their income into both types of accounts so they have two different â??buckets of money growing over their lifetime,â?• he says. â??Think of it as a way to diversify from a tax-standpoint,â?• Jones says.

This approach will also create flexibility when it comes time to spend the money in retirement, since Roth accounts are not subject to required minimum distributions. â??The old adage says that you shouldnâ??t put all of your eggs in one basket. People are pretty good about that when it comes to choosing different asset classes,â?• Jones says. â??So, why not also do it when choosing different â??taxâ?? classes?â?•

Some basic facts about Roth retirement savings plans:

Taxes. You pay income taxes on the contributions at the time that they are deducted from your paycheck.

Contributions. 401(k) and 403(b) plans allow you to make contributions in total of $18,000 for 2015 and 2016, plus an additional $6,000 in 2015 and 2016 if you are age 50 or older at the end of the year. If your plan offers one, you can put some or all of that amount into a Roth account. You can split it up however youâ??d like.

Earnings. The earnings on your Roth 401(k) contributions are tax free as long as you leave them in your account for at least 5 years and withdraw them after you are age 59 1/2. This means that, during retirement, the distributions from your Roth 401(k) account will be paid to you tax-free.

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948, or schedule an appointment with a retirement counselor today.

Source: Internal Revenue Service. www.irs.gov.

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