

With a combined 50+ years of experience, 2X Wealth Group is committed to educating and empowering investors. We firmly believe financial literacy helps people make better decisions.

To Roth or Not? Picking the Best Retirement Plan Option

Nothing in this world is certain except death and taxes. One of the important decisions that faces everyone who is saving for retirement is whether to pay taxes now or later.

The basic difference between traditional retirement accounts and Roth accounts is the tax treatment.

Traditional IRAs and 401ks* are funded with **pretax** dollars. Roth 401k plans and Roth IRA plans are funded with **after tax** dollars. Although both types of retirement accounts allow your retirement savings to grow tax free, qualified distributions from **traditional** retirement accounts are taxed at ordinary income rates. In contrast, qualified distributions from **Roth** retirement accounts are tax free (*see attached table*).

There are two types of Roth retirement accounts - a Roth 401k and a Roth IRA.

Many can and do take advantage of company sponsored 401k plans, but they are often unaware that their companies offer Roth 401k plans.

The similarities between a Roth 401k plan and a Roth IRA:

- Funded with after-tax contributions
- Allow you to accumulate returns on your money tax-free
- Distribute money tax free without penalty as long as you are 59-1/2 and have held the account for at least 5 years

*We use the term 401k in this blog, but the concepts apply equally to 403b plans (provided by employers who are non-profit).

The differences:

- **Roth 401k plans** have no income limit for contributions.
- **Roth 401k plans** require withdrawals at 72 or when you retire, whichever comes later. There are no required withdrawals starting in 2024.
- If your employer allows it, you can borrow against your **Roth 401k**, up to \$50,000 or 50% of your vested account balance, whichever is less.
- **Roth IRAs** have income limits for contributions and do not require withdrawals at any age.
- Unlike Roth 401k plans, **Roth IRAs** allow penalty and tax-free withdrawals of your **contributions** after a 5-year holding period.

How do you decide between a Roth and traditional pre-tax IRA or 401k plan?

The government gets its money one way or another, either going in or coming out.

The goal is to figure out when it is best to pay the taxes. If you are a high earner now and expect to pay lower taxes upon retirement, a traditional retirement plan may be best for you. If you are just getting started in your career and expect your income to grow over time, a Roth may be the preferred option. Many people opt to contribute to both types of accounts which offers flexibility in withdrawal strategies in retirement.

Is it possible to contribute to both a 401k plan and an IRA?

If you can afford to save more money for retirement, it is possible to contribute to both types of retirement accounts but watch out for income restrictions on contributions to a Roth IRA. If your income is too high, you could contribute to both a 401k plan and a traditional IRA. However, the tax deductibility of the IRA contribution is subject to income limits if you and/or your spouse work for a company with a retirement plan. The attached table is a useful guide.

If you have limited funds, what retirement account should you fund first?

Most companies offer matching contributions for their 401k plans, and the company match amount is always placed in the traditional (pretax) 401k. We recommend that you max out your company match before making other retirement investments – the match is basically free money.

Lesser-known contribution and withdrawal rules

- Even in *single earner* couples, contributions can be made to *both* spouse's IRAs (must meet income limits for Roths).
- Hardship withdrawals *without* penalties exist for all types of retirement accounts. Hardships include buying a first house, paying for education expenses, paying for medical insurance after losing a job, etc. While penalties won't apply, you will still owe ordinary income tax on traditional IRA or 401k accounts.
- Rule of 55 – you can withdraw funds from your current job's 401k or 403b with no 10% tax penalty if you leave that job in or after the year you turn 55.

Helpful Planning Strategies

When it comes to retirement and estate planning, Roth accounts are superior because they offer tax-free earnings and tax-free withdrawals for you and/or your heirs. Implementing the following Roth boosting strategies generally requires investment and tax advice.

- **The Back Door Roth IRA** is a way of creating more Roth savings when you are above the income limit for contributing to a Roth IRA. This strategy is trickier when you have large traditional IRA accounts.
 - Make an after-tax contribution to a traditional IRA.
 - Roll the traditional IRA to a Roth IRA.
 - If there are any earnings on the contributions made to the traditional IRA, taxes on earnings will be owed after the rollover - an incentive to roll over quickly!
 - If you also have a large *traditional* IRA, pro-rata taxes hurt this strategy, but there are workarounds.
- **After Tax 401K/Roth 401k Conversions (also called mega back door Roth)**
 - If your company plan offers *after-tax* contributions in addition to the more typical traditional and Roth contributions, you have additional opportunities to create Roth savings.
 - This strategy creates Roth savings very quickly... as much as \$43,500 per year.
 - If your company makes matching contributions, they will reduce the amount of after-tax contributions you can make.

Your retirement savings strategy should be based on your own employment, income, and other financial planning considerations. 2X Wealth Group provides specific retirement planning advice based on your unique circumstances. If you believe that you can take advantage of additional Roth savings and want advice as to what steps to take, send us an email.

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Need help sorting this all out? Make an appointment with us to help you through it.

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	Traditional 401K	Roth 401K	Traditional IRA	Roth IRA
Who can contribute?	An employee of a company that offers a 401k plan	An employee of a company that offers a ROTH 401k plan	You can contribute if you (and/or your spouse) have taxable compensation and one of you is still working. The contribution may not be tax deductible depending on your income.	You can contribute if you (and/or your spouse) are working and have taxable compensation below the IRS income limits https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2023
Are there contribution income limits for contributions?	No	No	There are no income limits for traditional IRAs, but there are income limits if you want to make the contribution tax deductible.	Yes, with partial contributions possible at certain income levels
Are contributions pre-tax, after tax, or tax deductible?	Pre- tax	After Tax	Tax deductible if you qualify	Not Tax Deductible
How much can I contribute for 2022?	Contributions have to be made in the same calendar year	Contributions have to be made in the same calendar year	\$6000,+ \$1000 if 50 or > ; but the total contribution cannot exceed your annual earned income. Contributions can be made up until April 15th of the following year.	If you meet the requirements, \$6000,+ \$1000 if 50 or > ; but the total contribution cannot exceed your annual earned income. Contributions can be made up until April 15th of the following year.
How much can I contribute for 2023?	\$22,500+ \$7500 if 50 or over	\$22,500+ \$7500 if 50 or over	\$6500,+ \$1000 if 50 or > ; but the total contribution cannot exceed your annual earned income	
What are the total employee and employer contribution limits for 2023?	\$66,000 (\$73,500 including 50 or over catch-up)	\$66,000 (\$73,500 including 50 or over catch-up)		
What are the catch-up amounts for 50 or over in 2022?	Contributions have to be made in the same calendar year	Contributions have to be made in the same calendar year	\$1,000	\$1,000
What are the catch-up amounts for 50 or over in 2023?	\$7,500	\$7,500	\$1,000	\$1,000
Do I have to take Required Minimum Distributions (RMDs)?	Yes, starting at age 73. You can delay your first RMD until the year you retire if you do not have a 5% or more ownership stake in your employer.	Yes in 2023, but starting in 2024, RMDs no longer required.	Yes, starting at age 73. The amount is determined by the fair market value of your IRA at the end of the previous year, your age and your life expectancy.	No
Am I taxed on my distributions?	Yes, withdrawals from Traditional 401ks are taxed as ordinary income.	Contributions are not taxed when you withdraw them from the plan. Earnings on contributions are not taxed if you are making a qualified distribution (i.e. made after a 5 year period of participation and after age 59-1/2.	Yes, withdrawals from Traditional IRAs are taxed as ordinary income.	Contributions are not taxed when you withdraw them from the plan. Earnings on contributions are not taxed if you are making a qualified distribution (i.e. made after a 5 year period of participation and after age 59-1/2).
Do penalties apply for early withdrawals?	Yes, if withdrawals are taken before age 59-1/2, there is a 10% tax penalty. The IRS provides hardship exemptions, and if you leave a job at 55, penalties are waived. See Rule of 55.	10% Penalty may apply to earnings if withdrawals are made before 59-1/2 and haven't met the 5 year rule. The IRS provides hardship exemptions.	Yes if withdrawals are taken before age 59-1/2 there is a 10% tax penalty. The IRS provides hardship exemptions.	10% Penalty may apply to earnings if withdrawals are made before 59-1/2 and haven't met the 5 year rule. The IRS provides hardship exemptions.

"If you file a joint return, you may be able to contribute to a IRA or a Roth IRA even if you did not have taxable compensation as long as your spouse did. The amount of your combined contributions can't be more than the taxable compensation reported on your joint return. If neither spouse participated in a retirement plan at work, all of your traditional IRA contributions will be deductible.

"While we use the term 401k for brevity, the same rules apply to 403b plans.