Roth Contributions

What is Roth?

A Roth deferral is an after-tax contribution, which means you must pay current income tax on the deferral. Since you have already paid tax on the deferral, you won't pay tax on it again when you receive a distribution of your Roth deferral. In addition, if you satisfy certain distribution conditions, you won't have to pay tax on the earnings either. This means that the distribution of the Roth earnings can be tax-free, not just tax-deferred.

What factors should I consider in deciding whether to make a Roth deferral or a pre-tax deferral to a 401(k) or 403(b)?

Your decision to make Roth deferrals or pre-tax deferrals involves a number of factors that are discussed below. In general, the longer Roth deferrals remain in the plan, the more favorable they are (i.e., the Roth deferrals may result in more tax savings than pre-tax deferrals). The factors to consider when deciding whether to make Roth or pre-tax deferrals to your 401(k) or 403(b) plan depends upon many unknown items. Because of this, it is sometimes suggested that you consider making both pre-tax deferrals and Roth deferrals.

<u>Ability to afford higher contributions</u>

One of the most important items to think about is whether your decision to contribute pre-tax deferrals or Roth deferrals will affect the amount of salary deferrals that you can afford to contribute to the plan. If you can afford to contribute the same dollar amount of salary deferrals, regardless of whether they are pre-tax deferrals or Roth deferrals, then that means you should think more about making Roth deferrals. Your ability to afford higher contributions becomes more important in two situations: (1) when a plan provides for a matching contribution, or (2) when you want to contribute the maximum amount allowed by the plan or by the law. In the case of matching contributions, it is to your benefit to contribute the maximum amount that will be matched under the plan. If you are not able to contribute enough Roth deferrals to receive the maximum matching contribution, then you may be better off making a larger contribution with pre-tax deferrals.

<u>Current and future tax rates</u>

Another item to think about is your federal income tax rate at the time of the contribution, compared to your expected tax rate at the time you would receive a distribution. Pre-tax deferrals are taxed when distributed. Roth deferrals are taxed when these are made to the plan. If you believe that your tax rate will be lower in the future when you receive distributions from the plan, then you should consider making pre-tax deferrals to the plan. If you believe that your tax rate will be higher when you receive distributions from the plan, then you should consider making Roth deferrals.

<u>When the deferrals will be withdrawn</u>

You should also think about when you will want, or need, to withdraw the contributions from your account. If you think you will withdraw your contributions before you satisfy the "5-year participation requirement," then you may be better off making pre-tax deferrals. Another factor is whether you will accumulate funds in a retirement plan for as long as possible. You must begin receiving RMDs from the plan by the later of your retirement or your attainment of age 73. For estate planning purposes, you may want to delay the receipt of distributions beyond your retirement or your attainment of 73. You can lower the RMD amount by contributing more money to a Roth account within your 401(k) 0r 403(b) plan.