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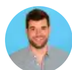
New to investing? 'Run' to this tax-advantaged retirement account, says CFP

Published Thu, Jun 22 2023•1:41 PM EDT



Ryan Ermey

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If your workplace offers a 401(k) plan — and especially if they match up to a certain percentage of your contributions — just about every financial planner in America would urge you to invest.

But it's not as simple as opting in to your employer's plan. In nearly 9 out of 10 plans, you'll be presented with a choice: Do you want a traditional 401(k) or a Roth?

Traditional plans, which come with an upfront tax break and are funded with pre-tax dollars, are far more prevalent. But Roths, which you fund with money you've already paid taxes on, are growing in popularity. Some 28% of workers made Roth contributions in 2021, up from 18% in 2016, according to the Plan Sponsor Council of America.

No one type of account is right for everyone, but younger investors would be foolish to overlook the Roth option, says Jeremy Finger, a certified financial planner and founder of Riverbend Wealth Management.

"Younger, mid- to lower-income employees should run to the Roth 401(k)," he says. "They're paying lower taxes on their contributions, and they have longer for the money to compound."

What's more, a couple of changes to the laws regarding Roth 401(k)s in last year's "Secure 2.0" legislation have made the

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accounts even more attractive. Here's why financial experts say you'd be wise to invest at least some of your retirement savings in one.

How Roth 401(k)s work

In a traditional 401(k), contributions are made with pre-tax money that counts against your taxable income. In exchange for this upfront benefit, you owe income tax when you withdraw the money in retirement.

Roth accounts' tax break works in reverse. Because you fund these accounts with money you've already paid tax on, you can't deduct your contribution on your taxes. But provided you're 59½ and have held the account for at least five years, money you withdraw in retirement — including your earnings — is tax-free.

Given this dynamic, many earlier-career workers favor Roth accounts. If you're earning less and therefore in a lower tax bracket, it makes sense to pay taxes now rather than later, when you could be earning much more.

"I tell all my young career clients to max out their Roth," says Catherine Valega, a CFP with Buzzing Bee Advisory in Boston, Massachusetts. But as her clients grow

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older and wealthier, she adds, it makes

more sense for them to take the immediate tax advantage offered by a traditional account.

Even for wealthy clients, a Roth still provides a useful hedge in the event that tax rates go up across the board. In fact, given that tax rates are set to rise in 2026 when the current brackets established by the Tax Cuts and Jobs Act expire, “I’m even working with really high net worth clients, saying, ‘Let’s take advantage of lower tax rates now versus in the future,’” Valega says.

Roth 401(k)s vs. Roth IRAs

If you’re thinking the rules for Roth 401(k)s sound similar to those for Roth IRAs, you’re right. But there are a few key differences.

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Plus, you can contribute a lot more to a Roth 401(k) than a Roth IRA. For 2023, you can contribute up to $22,500 to a Roth 401(k), plus an extra $7,500 for those age 50 and up. Roth IRAs, meanwhile, come with a $6,500 contribution limit, plus an extra $1,000 if you’re 50 or older.

One drawback for 401(k) investors: Any

One drawback for 401(k) investors: Any

withdrawal before age 59½ is subject to a 10% penalty. The same is true of an IRA if you withdraw your earnings, but you can withdraw up to what you've contributed to a Roth IRA at any time without owing tax.

Tax law changes that benefit Roth 401(k) investors

Secure 2.0, passed in 2022, included a handful of provisions that made investing in a Roth even more attractive compared with other types of retirement accounts.

1. No required minimum distributions

Under the old rules, unless you were still an employee and didn't own 5% of the sponsoring company, you had to begin taking distributions from your Roth 401(k) the year you turned 73 (or 70½ if you reached that age before January 2020) or face a penalty from the IRS.

That rule never applied to IRAs, and was easy enough to skirt by rolling your 401(k) into an IRA, but it's no longer something to worry about — Secure 2.0 eliminated it starting in 2024.

"Investing in a Roth 401(k) or IRA puts you in a position where you don't have to worry about being in partnership with the

government over when you use your money," says Finger.

2. A better deal for heirs

Under the new legislation, if you pass a 401(k) to a non-spouse, that individual must generally receive all the money in the account within 10 years of inheriting it (or within 10 years of coming of age, in the case of a minor). That means those who inherit traditional accounts have some potentially tricky tax planning.

But those who inherit Roths won't owe taxes on the money they withdraw.

By investing in a Roth, "you're basically making the call that, 'I'm going to take care of this now for my kids.' It's the long-term strategic thing to do," says Valega.

3. Roth employer matches

Until recently, if your employer matched up to a certain percentage of your Roth 401(k) contributions, the matching dollars were put into a traditional 401(k). Under the new rules, employers can opt to match your contribution using Roth dollars.

Don't expect every workplace to offer this overnight, though, says Valega. "It may take employers a couple of years to actually put this into practice," she says.

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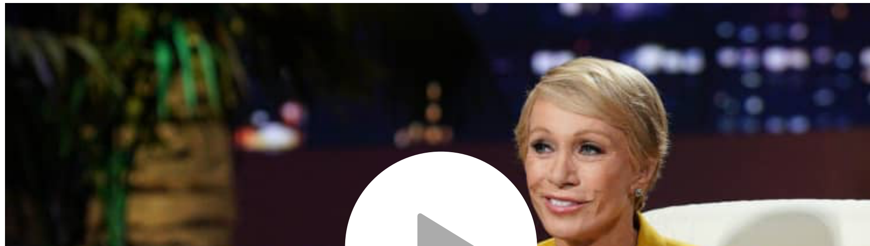

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