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Speaker One

Welcome. My name is Andrew Baron, and this is, Well… It Depends! The podcast where I present pros and cons of different financial decisions so that you, the audience, feel better informed when you're confronted with these decisions in your own life. In this episode, I asked a question "Should I contribute to a traditional or Roth 401k?".

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Speaker One

But before we began a short disclaimer, this is being recorded on May 10th, 2023. The contents of this podcast are strictly for information purposes only, and nothing said should be taken as investment, tax or legal advice. It is important to consult with a professional before making any financial decisions, as the strategies discussed may not be suitable for you specifically. Getting into it; should I contribute to a traditional or a Roth 401k? Well… It Depends!

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Speaker One

Understanding retirement savings strategies can be challenging, and many people may not be sure whether they should contribute to a traditional or a Roth 401k at work. Let's examine several of the options and where they might be a good fit. First, let's start off by talking about traditional 401K's. The main thing behind traditional 401K's are that contributions are made with pre-tax dollars.

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This means that you will pay less taxes today, because your contributions reduced your taxable income. This can be especially beneficial if you are in those higher tax brackets during your working years. Besides getting the tax benefit on your contributions today by reducing your taxable income, you may qualify for additional tax credits and deductions. Additionally, another big benefit about traditional 401K's are that everything inside the account grows tax free.

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Speaker One

This means all the interest, dividends and capital gains accumulate tax free and are not taxed until distributions. So, what about some of the negatives of a traditional 401K? One of the big things are required minimum distributions or RMD’s. This means that those that were born before 1960 at age 73 or after 1960, beginning at age 75, must begin taking money out of the account, whether they need it or not.

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These distributions are taxed at ordinary income rates, which means you may be paying higher tax rates in the future for a lower tax rate today. Now let's take a look at Roth 401k accounts. Roth 401k accounts work a little bit differently than traditional 401K’s. In this case, your contributions are made with after tax dollars in exchange for tax-free distributions in retirement.

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This can be especially advantageous if you expect to be in a high tax bracket in retirement. Unlike traditional 401K’s, Roth 401K’s are not subject to RMDs beginning in 2024, this means that if you have a Roth 401K and are age 73 or older, you still need to take your RMD in tax year 2023.

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Speaker One

Similar to traditional 401K’s, Roth 401K’s get the benefit of tax free accumulation. This is to incentivize people to save for their retirement by letting the funds grow tax free. So what are some of the cons of a Roth 401K’s? Roth 401K’s make you pay tax on your contributions today, in exchange for tax free distributions. However, you may be paying at a higher tax rate than you would have in retirement.

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Speaker One

Additionally, you may have lower take home pay if you made the same contributions in a traditional 401K, you would have a higher amount than the same contributions in a Roth 401K. Historically, all employer contributions to 401K plans have been made on the pre-tax contributions side. This means that participants were not taxed when the contributions were made and instead were taxed upon distribution.

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Speaker One

However, upon a recent update in the Secure 2.0 Act, this has been remedied where employees can now elect that all matching and nonselective contributions be made to the Roth side. This means that participants would be taxed when the contributions were made, but all distributions would be tax free. Remember, not all features will be available to all 401K plans and you should check with your provider to see if this pertains to you specifically.

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Speaker One

To recap, while both accounts get the benefit of tax-free growth, traditional 401K accounts provide a tax benefit today to provide for taxable distributions in the future, while Roth 401K accounts are taxable today so that your distributions in retirement are tax free. Therefore, deciding between a Roth and a traditional 401K comes down to your own financial situation. Future and current tax rates and your own retirement goals. So, to answer the question, should I contribute to a traditional or a Roth 401K. Well…
It Depends!