What's the Difference Between 401(k)'s and Roth 401(k)'s? - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Show, I'm your host Tom Mullooly, and this is episode number 142. Thanks for tuning in. Great article in the Wall Street Journal today, May 31st, 2019, written by Laura Saunders. Basically, they opened up the gates recently and said, "Send us all of your questions on Roth IRAs and Roth 401ks." So there's more money that's now going into individual retirement accounts and 401ks than are in pensions, and that's really ... Even though pensions haven't been around for much of the last few years, there still was this gigantic pool of money.

So there's actually ... 60% of all money in retirement accounts is now in 401ks and IRAs. And as recently as 20 years ago that number was around 40%. So each year, as you may know, they've been ratcheting up the amount that folks can contribute. If you're working, you can put 19 thousand dollars, now, into a 401k. 25 thousand dollars in a year if you are over age 50. And this is where it gets a little confusing. Employers can make a match on the contribution, that doesn't affect your contributions. The thing you need to know is that the combined total of money going into your plan can exceed 56 thousand dollars if you're under age 50, or 62 thousand if you're over the age of 50.

That's a question that we get asked quite a bit here in the office. People say, "Hey, I want to max out my retirement plan at work, but I know my company makes a match. What's going to happen with that?" So the individual account, the individual IRAs and Roth IRAs, limits are much, much lower. So if you're under age 50 for a traditional IRA or a Roth, you can put 6000 dollars a year into one of these accounts. If you're over the age of 50, you can put 7000 dollars a year into a traditional IRA or a Roth.

So, the Roth IRAs get phased out though. If you're a single-filer in 2019, if you have adjusted growth income of 137 thousand dollars or more, not eligible to put money into a Roth. If you're married, filing jointly, the threshold is now 203 thousand dollars. We sit down with clients all the time and they say, "Oh, I make too much money to put into a Roth." Check the numbers, they're going up as well.

Each year, you might still be eligible. And it's not on the top line, it's on adjusted gross income. So the real question about, "Should I do a Roth, should I do a traditional retirement plan?" It really depends on when your taxes are paid. With a IRA or 401k, the money goes in pre-tax. You are going to pay tax on that money at some point down the road in the future. With a Roth ... People get confused about this, but here's a very simple thing to remember.

With Roth IRAs, the money is always, always, always after tax dollars. And so there's a long debate about, "What's better? Should I put money into a pre-tax plan and just pay the tax later? Should I put money into a Roth and pay the tax up front?" Some people just don't like writing a check today for their taxes. I totally get it. The real determinant is what's going to be your tax rate when that money comes out? When the money comes out of a Roth IRA, and it may never come out of a Roth IRA, you can kick this can down the road into the next generation. You've already paid the tax, so you're not going to have to worry about it.

What's going to be your tax rate on 401k money, on IRA money? It's hard to tell. It's really hard to tell. So, some of the things that the article went on to talk about was, hey, if you're thinking about retiring and moving to ... From a high-income tax state to a lower income tax state, that's something to consider. It really kind of depends on your situation. These topics come up all the time in our conversations with clients. That's why we ask you, get in touch with us. We'll be happy to talk to you about your situation and crunch the numbers. We'll go through an analysis for you and show you what the numbers may look like with this kind of tax bracket, that kind of tax bracket.

We'll be able to run those numbers, and at least give you some things to think about on whether it's better to keep the money in a traditional plan, or maybe think about doing a Roth conversion. That's a topic for another day. But thanks for tuning in and catching up with us on episode 142 of the Mullooly Asset Show, see you on the next episode.