RETIREMENT BASICS

Is Roth Right for You? Explore the Features and Potential Benefits of a Roth 401(k)

mfs.com

With more employers offering Roth 401(k)s, it's important to understand some of the ways traditional and Roth 401(k)s are the same and different.

While both provide tax benefits and similar features, the key difference between them has to do with how they are taxed. With a traditional 401(k), taxes are paid when you take money out in retirement. With a Roth 401(k), taxes are paid when you make contributions.

The table below compares some of the features of Roth and traditional 401(k) plans for 2024.

	ROTH 401(K)	TRADITIONAL 401(K)
CONTRIBUTION LIMITS[1]	\$23,000 (\$30,500 if age 50 or older)[2]	\$23,000 (\$30,500 if age 50 or older)[2]
TAXATION OF CONTRIBUTIONS	Contributions are not tax deductible.	Contributions are tax deductible.
TAXATION OF WITHDRAWALS	Withdrawals of contributions and earnings are not taxed provided it's a qualified distribution, the account is held for five years and the withdrawals are made as follows: ▪ Due to disability ▪ Upon or after death ▪ On or after age 59-½	Withdrawals of contributions and earnings are subject to federal and most state income taxes.
REQUIRED MINIMUM DISTRIBUTIONS[3]	Starting in 2024, Roth 401(k) accounts will not be subject to RMD requirements.	For 2024, distributions must begin no later than age 73 and must be taken by April 1 of the year following the year you reach age 73, unless still working and not a 5% owner.

[1] Source: https://www.irs.gov/newsroom/401k-limit-increases-to-23000-for-2024-ira-limit-rises-to-7000.

[2] Effective in 2025, for those aged 60 to 63, the catch-up limit will increase to the greater of \$10,000 or 150% of the regular catch-up amount for those aged 50+. Effective in 2024, participants with compensation exceeding \$145,000 will only be allowed to make catch-up contributions on a Roth after-tax basis, however, the IRS delayed the effective date of this provision by two years, allowing sponsors to begin administration in 2024 if desired but permitting them to delay implementation until January 1, 2026.

[3] The SECURE 2.0 Act of 2022 provided separate rules for hardship withdrawals and certain penalty-free early plan distributions.

When deciding if a Roth 401(k) is right for you, considering how your income tax rates might differ in retirement versus in your working years is critical. If you expect to be in a higher tax bracket when you make withdrawals, a Roth 401(k) could be beneficial. Consider the following hypothetical example:

Aisha's employer allows contributions to either a traditional or Roth 401(k). In the table below, she determines how much she can save to each type of account with the goal of having the same take home pay.

Key assumptions

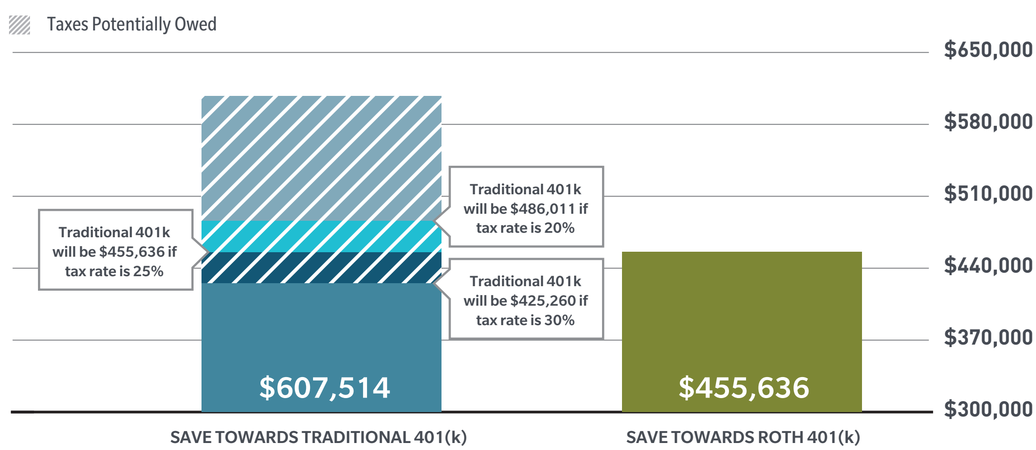
- Age: 35
- Salary: $100,000
- Pre-retirement effective tax rate: 25%[2]
- Pre-tax savings rate: 6%
- Post-tax savings rate: 4.5% (equals 6%* (1%–25%))
- Annual Investment Returns: 6%
- Retirement age: 65

	ROTH 401(k)	TRADITIONAL 401(k)
(A) Aisha's salary	$100,000	$100,000
(B) Pre-tax salary to be directed towards retirement savings 6%* (a)	N/A	$6,000
(C) Salary subject to tax (a) – (b)	$100,000	$94,000
(D) Taxes owed (25%* (c))	$25,000	$23,500
(E) Post-tax amount to be directed towards retirement savings 6%* [(c)-(d)]	$4,500	N/A
(F) Take home pay (c) – (d) – (e)	$70,500	$70,500

In either scenario, based on key assumptions, Aisha’s take-home pay is the same, however her contribution ($4,500) to the Roth 401(k) is lower because she must pay taxes on those contribution dollars.

In the Roth scenario, Aisha's account will grow to $455,636, which will not be subject to income tax upon withdrawal. For the traditional scenario, based on the key assumptions, the account will grow to about $607,514, which will be subject to income tax when it is withdrawn. Aisha estimates the after-tax value of this account at retirement under three different tax rate scenarios: 20%, 25% and 30%.

Roth 401(k) vs. Traditional 401(k)



At first glance, the traditional 401(k) account seems to be the better option. Yet when you factor in taxes, the story changes. In 30% tax bracket, the Roth 401(k) may provide more income while in lower tax brackets (*i.e.*, 20%), the traditional 401(k) may be better. While the Roth account has the potential to provide flexibility and tax benefits in retirement, there are several factors to consider. Talk with your financial advisor, investment professional, accountant or attorney to determine if a Roth 401(k) might be a good fit for you.

[1] Limits shown are for the 2024 tax year.

[2] For illustrative purposes only. There is currently not a federal marginal tax rate of 25%.

These hypothetical examples are for illustrative purposes only and are not intended to predict the returns of any investment choices. Rates of return will vary over time, particularly for long-term investments. There is no guarantee the selected rate of return can be achieved. Any investments may have fees and expenses that are not taken into account, which would lower the performance. Regular investing does not ensure a profit or protect against loss in declining markets.

Contact your financial advisor or investment professional if you have questions on these limits or are considering making any changes to an existing IRA or 401(k).

MFS FUND DISTRIBUTORS, INC., MEMBER SIPC, BOSTON, MA MFSP_FLY_1227156_1_24 51487.3