

ROTH IRAs AND 401(k)s

The Roth IRA will celebrate its 25th birthday in 2022. With that being the case, some individuals are still not familiar with the advantages associated with Roth IRAs. In this article we will discuss some of the characteristics of these vehicles while identifying some opportunities that might be of interest.

Contributions and Distributions

While anyone with earned income (or spousal earned income) can contribute to a traditional IRA (even though the contribution may or may not be tax deductible), Roth IRA contribution eligibility is mostly driven by an individual's adjusted gross income. For 2021, the contribution limit for traditional IRAs and Roth IRAs is \$6,000; individuals who are age 50 or older may contribute an additional \$1,000. And then with regards to distributions, assuming the individual has met certain requirements (the individual is 59.5 or older and at least five years have passed since the initial contribution), Roth IRA distributions (including any growth within the account) will not be subject to tax or penalty.

Required Minimum Distributions

While traditional IRAs have required minimum distributions (RMDs) beginning at age 72 (previously age 70.5), Roth IRAs do not require any RMDs during an owner's lifetime, which allows these accounts to grow uninhibited within a tax-free environment. This reality allows for greater flexibility within retirement while potentially allowing for more of an individual's Roth IRA to pass on to his or her beneficiaries.

Roth 401(k)

Most employer sponsored retirement plans have a Roth 401(k) option for their employees. Roth 401(k)'s allow plan participants to contribute after-tax dollars to their 401(k) directly from their paycheck, where they'll benefit from the same tax treatment afforded to the Roth IRA. However, unlike with Roth IRAs, there are no income limits with Roth 401(k) contributions, and individuals are able to contribute up to the current limit of \$19,500 per year (and an additional \$6,500 if age 50 or older) - significantly more than the maximum Roth IRA contribution (\$6,000 or \$7,000).

Roth Conversion

A Roth IRA conversion simply entails moving money from a traditional IRA into a Roth account. This "conversion" is a taxable event, as the amount of the conversion will be considered income in the year of the conversion. However, once these funds are in the Roth IRA, they will be subject to the same tax treatment alluded to above (tax-free growth!). Of note, the "five-year rule" alluded to above also applies to conversions; as such, we recommend consulting an advisor when considering a conversion.

Tax Rates and Estate Planning

Roth IRAs have drawn some additional interest of late as the Biden administration has put forth proposals involving some significant tax changes. Some of the proposed changes entail increasing tax rates for higher income earners while drastically reducing the federal estate tax exemption amount.

Some individuals are considering Roth IRA conversions in 2021 to benefit from current tax rates in anticipation of them being higher going forward. A conversion will also reduce the size of a taxable estate (by the amount of the tax paid on the conversion). Others are taking into account the new rules (as of 2020) surrounding inherited IRAs, and the requirement that (in some cases) beneficiaries fully distribute inherited IRAs within 10 years of the original owner's death. Therefore, if a parent realizes their children would be adversely impacted by more income from these required distributions (that might be taxed at a higher rate than what they'd pay on a conversion today), he or she might be inclined to convert some or all of their IRA to a Roth IRA so that their children inherit a Roth IRA, whose distributions will not be taxable.

So while using a Roth IRA or 401(k) in some capacity may sound like a compelling proposition, it is usually a good idea for individuals to engage with trusted advisers before implementing any changes. Individual circumstances (age, income, retirement expectations, etc.) will go a long way in determining whether or not it makes sense to consider changes.

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