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A RetireReady Publication

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Traditional 401(k) Vs. Roth 401(k): Which Is Right for You?

If you participate in your company's retirement plan, you face many choices, including where to deposit the money you regularly contribute from your paycheck: a traditional or Roth 401(k) account. If you've wondered what the differences are and which option is best for you, the answer is: *it depends!* Below are important things to understand about how traditional and Roth deferrals function in workplace retirement plans.*

What's the Difference Between Traditional and Roth 401(k) Contributions?

The main difference comes down to when you pay the taxes: when you deposit the money versus when you withdraw it.

When you make a traditional contribution, the amount is deposited into your retirement account before taxes are taken out, reducing your taxable income. Take the example of Ken, who earns \$675 per week and defers \$75 from his paycheck into his traditional 401(k) account. Because he's deferring taxes on the \$75 contribution, Ken's taxable income is \$600 (\$675 minus \$75). At Ken's federal tax rate of 22 percent, he will pay \$132 in taxes—\$16.50 less than if he had been taxed on his total paycheck. You won't pay taxes on those savings until you take money out of your account, at which time both your contributions and investment earnings are subject to income tax.

A Roth 401(k) contribution is deposited into your account *after* you've paid taxes on it. Because of this, you won't have to pay taxes on it again when you withdraw it from your account. So, \$20,000 in a Roth 401(k) account is \$20,000—you won't pay taxes when you withdraw it, including on the investment earnings, provided you meet a [few stipulations](#).

*Although most retirement plans offer a Roth option, it ultimately depends on your company's plan. To find out if you have the option, ask the benefits administrator at your company, visit the online web portal for your company's plan, or consult your company's retirement plan advisor.



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Which Option Is Best for You?

Choosing between a traditional and Roth deferral depends on several factors, including your financial situation and your retirement goals. Here's a good rule of thumb:

- **If your current income tax bracket is lower than (or equal to) what you expect it to be in retirement, choose the Roth 401(k) option.** Younger savers often fall in this category. Why? Because paying taxes now—when an individual's tax rate is presumed to be lower than it will be when their career advances, earning potential is increased, and tax rates rise over time—can be advantageous in the long run.
- **If your current income tax bracket is higher than you expect it to be in retirement, consider the traditional 401(k) route.** Being able to defer taxes can be an attractive benefit to older, experienced workers who find themselves in higher tax brackets and want the ability to lower their tax bills.

Can I Split My Contributions Between Traditional and Roth 401(k) Accounts?

Yes! If you contribute \$50 per week to your 401(k) plan, for example, you can deposit a portion into a traditional account and the remaining portion into a Roth account. Utilizing both options will diversify your tax situation in retirement, which is a great added benefit.

When deciding between a traditional 401(k) and a Roth 401(k) account, it's important to consider your financial goals and circumstances. Thankfully, there are plenty of useful—and free—online calculators that can assist you in modeling what your retirement plan contributions might look like in the future. If you're still unsure what the best option is for you, it's a good idea to consult a tax professional, financial advisor, or your company's retirement plan advisor.



Kick-Start Savings with the Saver's Credit

Many American workers know they should save for retirement, but that often takes a back seat to more immediate financial needs. There is, however, an incentive to save for retirement. It's called the "saver's credit," and it may motivate you to start saving today.

What Is the Saver's Credit?

Qualifying individuals may be eligible for a tax credit of up to \$1,000 for contributing to their IRA or employer's retirement plan. This saver's credit reduces the federal income taxes you pay on a dollar-for-dollar basis.

Contributions to 401(k)s, 403(b)s, 457 plans, SIMPLE IRAs, SEP IRAs, traditional IRAs, and Roth IRAs are eligible for the saver's credit. The saver's credit can also be taken for your contributions to an Achieving a Better Life Experience account if you are the designated beneficiary. Your adjusted gross income (AGI), combined with the amount of your contribution (less any recent distribution you may have received from your retirement plan or IRA), will determine the credit you receive. (You can also refer to the chart below.) Because the saver's credit is in addition to any tax deduction you may receive for contributions to your traditional IRA, it helps offset the cost of funding a retirement account and reduces your overall tax liability.

Do You Qualify?

To qualify for the saver's credit, you must:

- Be age 18 or older
- Not be a full-time student
- Not be claimed as a dependent on another person's return
- Not exceed a certain AGI level (based on your tax return for the year of the credit)

Depending on your AGI and filing status, you can claim a 10 percent, 20 percent, or 50 percent credit for the first \$2,000 you contribute to a retirement account during the year. If you are married filing jointly, the maximum eligible contribution is \$2,000 each for you and your spouse. Therefore, the saver's credit can be worth as much as \$1,000 for individuals and \$2,000 for couples who save in retirement accounts. The chart below describes the credit amounts relative to filing status and AGI.

2021 Saver's Credit Eligibility Guidelines			
Credit Rate	Married Filing Jointly	Head of Household	All Other Filers
50% of your contribution	AGI of not more than \$39,500	AGI of not more than \$29,625	AGI of not more than \$19,750
20% of your contribution	AGI of \$39,501–\$43,000	AGI of \$29,626–\$32,250	AGI of \$19,751–\$21,500
10% of your contribution	AGI of \$43,001–\$66,000	AGI of \$32,251–\$49,500	AGI of \$21,501–\$33,000
0% of your contribution	AGI of more than \$66,000	AGI of more than \$49,500	AGI of more than \$33,000

The Bottom Line

Remember, the key to taking advantage of the saver's credit is to participate in a qualifying retirement account. The fact that this is a credit and not a deduction makes it even more attractive because credits reduce your tax bill dollar-for-dollar.

So, if you haven't opened a retirement account or have one but haven't contributed, now is the time! If you think you may be eligible for the saver's credit, be sure to discuss the matter with your financial advisor or tax professional.



Take the No-Spend Challenge

Have you ever tried a no-spend day? One when you put your cash and bank cards away and live off of what you already have? The No-Spend Challenge could help prove you're thriftier than you think! Here are five ideas to incorporate in your challenge:

1. Bring lunch from home using food already in your refrigerator or cupboards.
2. Make coffee at home or enjoy coffee brewed at the office.
3. Ride a bike or walk to nearby destinations. You'll save on gas and reduce wear and tear on your vehicle.
4. Fill up on filtered water instead of bottled water and other costlier drinks.
5. Total the amount you save in your one day of not spending and "match" it by depositing the same amount in your savings account.

It may take practice to break old habits, but once you've mastered the No-Spend Challenge, double down and go without spending for two consecutive days. Or circle one day each month on your calendar and make that your designated no-spend day. Get your family and friends in on the act, too, and challenge each other to see who can be the most effective no-spend champ.

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Authored by the Retirement Consulting Services team at [Commonwealth Financial Network](#).

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