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The Battle of the Roth Options

The increasing popularity of both Roth IRAs and Roth 401(k) accounts is not surprising considering the increasing concern about future income tax hikes. Both Roth IRA and Roth 401(k) contributions are made with after-tax dollars, grow tax-free, and can be withdrawn tax-free as a qualified distribution. For those who believe tax rates are lower now than they will be when distributions are made, a Roth contribution often makes sense. (Since Roth accounts can be offered in 401(k), 403(b) and governmental 457(b) plans, this article's references to "Roth 401(k)" will apply to any of those plans.)

Anyone meeting certain income restrictions can contribute up to \$6,000, or \$7,000 if age 50 or older, to a Roth IRA for 2021 or 2022. Company plans are not required to offer Roth contributions. However, employees with a Roth 401(k) option can make Roth plan contributions of up to \$19,500, or \$26,000 if age 50 or older, in 2021 (\$20,500, or \$27,000 if age 50 or older, in 2022). Note that these Roth 401(k) limits are aggregated with pre-tax elective plan deferrals.

There is no combined limit for Roth IRAs and Roth 401(k)s. This means that it is possible to contribute the maximum amount to both a Roth IRA and Roth 401(k) in the same year.

Example 1: Sofie, age 52, is single and has a modified adjusted gross income

(MAGI) of \$100,000 in 2021. Sofie's 401(k) plan offers Roth contributions. Since her MAGI is below \$125,000 (the 2021 threshold for single taxpayers), Sofie can make a \$7,000 Roth IRA contribution for 2021. She can also make up to \$26,000 in Roth 401(k) contributions this year (\$19,500, plus \$6,500 catch-up), for a total of \$33,000 of 2021 Roth contributions.

Unfortunately, not everyone can afford to maximize both Roth IRA and Roth 401(k) contributions. *With limited dollars available to contribute, which option is better?* To help answer this question, consider the following advantages each option has to offer.

5 Roth IRA Advantages

1. No Lifetime RMDs: One significant advantage of Roth IRAs is that owners (and surviving spouses who roll over an inherited Roth IRA to their own Roth IRA) are not subject to required minimum distributions (RMDs) during their lifetime. By contrast, Roth 401(k) participants are subject to RMDs.

2. More investment options. Roth IRAs (and traditional IRAs) have almost unlimited investment options. The only prohibited investments are collectibles (except for certain coins minted by the U.S. Treasury), life insurance and S corporation stock. On the other hand, Roth 401(k) investments are restricted to the limited options offered by the plan.

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