T. Rowe Price
INSIGHTS®
INVEST WITH CONFIDENCE®

Would You Benefit From a Roth?

If you're in a low tax bracket now and expect to be in a higher bracket later, the answer may be yes.

When you're working and saving for retirement, you typically have a choice between traditional and Roth retirement accounts, including IRAs and 401(k)s. But how do you choose which account to open? "Taxes are a primary factor to consider," says Roger Young, CFP®, a senior financial planner with T. Rowe Price. "You don't want to pay more in taxes than necessary, so choose carefully."

The tax treatment of Roth and traditional accounts varies considerably. That's because the way you put money into these accounts and how you take it out later is very different:

- **Traditional retirement accounts** are funded with money on a pretax basis, meaning it comes straight out of your paycheck before you pay any taxes on it. This reduces your taxable income and essentially gives you a tax break for the same year. However, that tax break comes with strings attached. When it's time to start taking money out of those accounts, you're going to have to pay taxes on every dollar you withdraw.

- **Roth accounts,** on the other hand, are funded with money that you've already paid taxes on. So contributing to a Roth doesn't reduce your taxes today. However, qualified distributions are tax-free. (Generally, a distribution is qualified if taken at least five years after the year of your first Roth contribution and after you've reached age 59½.)

Working individuals who meet IRS income limitations can contribute to a Roth IRA or make pretax contributions to a Traditional IRA. And increasingly, retirement plans like 401(k)s allow designated Roth contributions in addition to pretax contributions. So more people are going to have a choice to make. (See "Roth or Traditional?" on page 2.) Here are some of the factors to help guide your decision.

KEY POINTS

- Roth and Traditional retirement accounts are taxed differently.
- Which account you choose should be based on your current and future marginal tax rates.
- Choosing the right account can help you avoid paying excess taxes.

Consider your current and future tax rates

"The main thing you'll want to consider when choosing between Roth and traditional accounts is whether your marginal tax rate will be higher or lower during retirement than it is now," says Young. If you think your tax rate will be higher, paying taxes now with Roth contributions makes sense. If your tax rate is likely to be lower in retirement, you can use traditional contributions to defer taxes instead. The recently lowered federal tax rates are scheduled to revert to pre-2018 levels after 2025, which may make Roth

CONTINUED >

PHOTOGRAPH BY SIDEKICK

contributions more attractive today. Of course, tax rates are hard to predict, due to changes in the law as well as uncertainty around your future income levels.

When a Roth may be right for you

Here are three situations where a Roth probably makes the most sense:

1. You are currently in a lower tax bracket, but you expect that to change. Let's say you are a young professional who is anticipating salary increases, which will put you in a higher tax bracket down the road. Contributing to a Roth IRA or Roth 401(k) means you pay the relatively low rate on taxable income now. Once you've retired, you will not pay any taxes on qualified distributions from the plan.

2. You are close to retirement and are concerned about RMDs. "If you've been a disciplined saver and have contributed a healthy percentage of your income to traditional accounts for many years, eventually you've got to pay the piper," says Young. Beginning in the year you reach age 70½, you must begin taking required minimum distributions (RMDs) from Traditional IRAs and from 401(k)s—including Roth 401(k)s—the later of age 70½ or once you're retired. As the name suggests, these withdrawals are required, even if you don't need the income at the time.

RMDs could bump you to a higher tax bracket. Qualified distributions from a Roth 401(k) or Roth IRA, on the other hand, would not create taxable income or increase your tax rate. Therefore, a Roth contribution may be preferable in order to limit the RMD income taxed at a higher rate.

CONTINUED >

Roth or Traditional?

Consider which account type may be most beneficial given several hypothetical investor scenarios.

Profile	Income	Tax Bracket	Situation*	Likely Benefits From
A young person in a low tax bracket who is likely to be in a higher bracket later	$50,000	12% (single)	The next higher tax bracket is 22%.	**Roth**
Someone who already has large traditional account balances and wants to minimize RMDs in retirement	$160,000	22% (married)	Approaching retirement with a $3.2 million 401(k) balance. An RMD (around $171,000 at age 80) plus Social Security is more than spending need and could bump household into 24% tax bracket.	**Roth**
A prodigious saver who can afford to contribute the IRS maximum either way	$130,000	24% (single)	Uncertain outlook for future tax rate. Can comfortably save $18,500 in a 401(k). After-tax savings are effectively $4,440 higher per year with Roth contributions.	**Roth**
A person in peak earning years who could be in a lower bracket during retirement	$360,000	32% (married)	Currently near bottom of tax bracket. The next lower tax bracket is 24%.	**Traditional**
Someone with a tight cash flow who wants the company 401(k) match while maximizing paychecks	$30,000	12% (single)	Contributes 6% to 401(k) to get full company match. Pretax savings provide $216/year more net pay.	**Traditional**

*Brackets are for federal taxes, based on rates as of January 1, 2018. While rates are scheduled to revert to pre-2018 levels after 2025, those rates are not shown in this table. Income refers to gross earnings; the current bracket reflects the standard deduction and potential retirement contributions. State taxes are not considered in the examples. Married status reflects joint filing.

3. You are a prodigious saver. Suppose you can contribute the maximum amount to a retirement plan ($18,500 for 2018 or $24,500 if you're over age 50), even if you don't get a tax break. In this case, the Roth account effectively enables you to save more in a tax-advantaged manner. Saving the maximum amount ultimately results in more after-tax retirement assets for the Roth account balance than a traditional contribution that is pretax.

When traditional could be the way to go

While a Roth is a good choice for many people, it's not best for everyone. Here are two examples where pretax contributions, such as to a Traditional 401(k) or a Traditional IRA, may be a better strategy:

1. You are in your peak earning years. When you retire, you might eliminate expenses, such as mortgage payments or college costs. Additionally, withholdings for payroll taxes and retirement contributions will go away. As a result, your income from Social Security and the amount you need to draw from retirement accounts likely will be less than what you earn today. So your federal tax bracket could be lower in retirement. Your state tax rate also could decrease, for example, if you move to an income tax-free state.

In this case, taking the tax benefit now with a traditional contribution may make more sense than the Roth contribution. You'll reduce your current taxable income while paying a higher tax rate and then make withdrawals at a potentially lower tax rate later in retirement.

2. You are struggling to save. The traditional pretax approach may enable you to get your employer's full 401(k) match with less impact on your take-home pay. This is because taxable income is reduced by the amount of your contribution.

> **"The main thing you'll want to consider when choosing between Roth and traditional accounts is whether your marginal tax rate will be higher or lower during retirement than it is now."**
>
> –**ROGER YOUNG**, CFP®, T. ROWE PRICE SENIOR FINANCIAL PLANNER

Having trouble deciding?

"If you're still unsure of what to do in your situation, the tiebreaker often should be in the Roth account's favor," says Young. That's because:

- Roth accounts generally are better for heirs, since assets can continue to grow tax-deferred.
- If you're like many people and have more assets in traditional accounts than Roth accounts, adding to your Roth assets improves tax diversification. This hedges against the risk of changes in tax laws or your personal circumstances.
- Roth IRA contributions (but not necessarily the gains) always can be withdrawn at any time or at any age without tax or penalty. But be careful—it's not as flexible for Roth 401(k) assets or assets that were converted from a Traditional IRA to a Roth IRA.

"While you should devote more energy to making sure you're saving enough," Young says, "a thoughtful decision between Roth and traditional contributions can help you take full advantage of those savings." ■

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

Important Information

This material has been prepared by T. Rowe Price for general and educational purposes only. This material does not provide fiduciary recommendations concerning investments, nor is it intended to serve as the primary basis for investment decision-making. T. Rowe Price, its affiliates, and its associates do not provide legal or tax advice. Any tax-related discussion contained in this material, including any attachments/links, is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding any tax penalties or (ii) promoting, marketing, or recommending to any other party any transaction or matter addressed herein. Please consult your independent legal counsel and/or professional tax advisor regarding any legal or tax issues raised in this material.

T. Rowe Price Investment Services, Inc., Distributor.

201902-718614