



With so many variables that factor into an individual's tax liability, it can be difficult to determine what the right strategy looks like for your situation. (UBS)

# Traditional or Roth?

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**For most families, a balance of Traditional and Roth contributions will provide the best results. However, this doesn't mean that you should contribute to both types of accounts equally. The UBS Chief Investment Office (CIO) provides an overview of Traditional and Roth 401(k) accounts, highlighting key factors that you should consider when deciding where you will direct your hard-earned savings.**

There's a reason why many Americans hold the bulk of their retirement savings in 401(k) accounts: They provide an opportunity for tax-deferred growth that compounds over time.

There are two main types of 401(k) contributions:

1. **Traditional deductible contributions:** Contributions are made on a pre-tax basis, investment earnings grow tax-free, and distributions taken in retirement are taxed at ordinary income tax rates.
2. **Roth contributions:** Contributions are made after income taxes are withheld, investment earnings grow tax-free, and qualified distributions are also free of income tax. Most 401(k) plans—but not all of them—offer a Roth contribution option. Unlike Roth IRA contributions, Roth 401(k) contributions are not subject to restrictions based on your income level.

With so many variables that factor into an individual's tax liability, it can be difficult to determine what the right strategy looks like for your situation. Add in the fact that there's no way to know with certainty what the future holds for tax rates, and this decision-making process is complicated even further.

Building your savings and retirement strategies around maximizing flexibility can be far more effective than strategies that rely on an accurate forecast of tax rates. And many investors are already building flexibility simply by saving across a mix of taxable, tax-deferred, and tax-exempt accounts.

When tax diversification is paired with a dynamic "decumulation" strategy in retirement—in which the retiree draws from their retirement funds in whichever sequence is more tax-efficient (taxable, tax-deferred, or tax-exempt)—investors

can effectively manage their liabilities without compromising on meeting their goals if tax rate changes differ from expectations.

### Next steps

1. **Enhance flexibility by diversifying tax treatments.** During your working years, prioritize your savings based on after-tax growth potential. Ideally, you will be able to spread your investments across a mix of tax treatments (taxable, tax-deferred, and tax-exempt), which will give you more options for managing the timing of your taxable income and realized capital gains in retirement. Our [2024 Savings waterfall worksheet](#) provides a good tool for evaluating this on a year-by-year basis, including a summary of the limits for 2023 contributions.

2. **Consider completing partial Roth conversions during lower-than-normal income tax years.** If you have lower-than-normal income one year, you may have an opportunity to complete Roth conversions at a lower tax cost by transferring a portion of your Traditional IRA/401(k) to a Roth IRA/401(k). The dollar amount of your Roth conversion will count as taxable income, so conversions in low-tax years are a great way to fund tax-exempt assets that will continue growing, won't be subject to lifetime RMDs, and will pass income tax-free to your beneficiaries. For more information, please see [Three strategies to improve your after-tax wealth potential](#).

3. **Revisit your contribution type annually.** For most families, a balance of Traditional and Roth contributions will provide the best results. However, this doesn't mean that you should contribute to both types of accounts equally each year—you should redirect your contributions as your circumstances change.

We generally recommend making Roth 401(k) contributions earlier in your career when your taxable income is low, and when your taxable income is higher later in your career, we suggest making Traditional 401(k) contributions.

There isn't an income level at which point every family should shift from Roth to Traditional. However, you should revisit your contribution type any time you move into a higher tax bracket because there is a greater chance of being in a lower tax bracket in retirement. And, since the largest jumps in our income tax system occur when moving from the 12% to 22% bracket and the 24% to 32% bracket, these are the two points where making the switch from Roth to Traditional may provide you with greater tax savings.

We suggest revisiting your contribution type annually and any time your tax situation changes (e.g., when you get a raise, your filing status changes, or if you move to a state with a higher or lower income tax rate). And don't forget about the standard deduction when figuring out where the threshold is for you.

Read the full report [Traditional or Roth?](#) 29 May 2024.

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On this episode of our 3-Levels podcast series, we explain the differences between traditional accounts and Roth accounts, including considerations when it comes to contributions, frequency of account reviews, and taxes: [3-Levels Podcast: Considerations for Traditional v. Roth accounts](#)

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