

## The Weekly Scenario: Roth IRA/401(k) Head to Head

December 17, 2021

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Both Roth IRA and Roth 401(k) contributions are made with after-tax dollars, grow tax-free, and can be withdrawn tax-free as a qualified distribution. If you believe your tax rates are lower now than they will be when distributions are made, a Roth contribution often makes sense.

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. Employer plans are not required to offer Roth contributions. If a company does offer a Roth 401(k) option, employees can make Roth plan contributions of up to \$19,500, or \$26,000 if age 50 or older, in 2021.

There is no combined limit for Roth IRAs and Roth 401(k)s. This means that you can contribute the maximum amount to both a Roth IRA and Roth 401(k) in the same year. That is a good outlay of cash to maximize both a Roth IRA and 401(k). If you were presented with both options, which is the correct one to choose?

### Advantages to a Roth IRA

1. No Lifetime Required minimum distributions (or RMDs): One of the most significant advantages of Roth IRAs is that owners are not subject to required minimum distributions (RMDs) during their lifetime. In contrast to Roth IRAs, Roth 401(k) participants are subject to RMDs.
2. More investment options. Roth IRAs have almost the universe of investment options. Prohibited investments include are collectibles, life insurance and S corporation stock. By contrast, Roth 401(k) investments are restricted to the limited options offered by the plan.
3. Easier accessibility. Roth IRA distributions can be taken at any time (note that earnings may be taxable and subject to the 10% early distribution penalty). With Roth 401(k)s, not so much. An employee still working cannot access his Roth 401(k) assets before age 59½ (except in cases of financial hardship).
4. Easier-to-satisfy “qualified distribution” rules. Earnings on both Roth IRA and Roth 401(k) contributions can be withdrawn tax-free as long as the distribution is considered “qualified.” A qualified distribution requires that the distribution be taken after a so-called ‘triggering event’ and satisfaction of a five-year holding period. Triggering events for both Roth IRA and Roth 401(k) distributions are attainment of age 59½, death, or disability (and also – for Roth IRA distributions, a first-time home purchase also qualifies). In general, the Roth IRA five-year holding period rules are easier to satisfy (I can’t go into all the details here so ...trust me?).

### Advantages of Roth 401(k)

1. Higher annual limit and no income restrictions. The annual Roth 401(k) contribution limits are significantly higher than the
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Roth IRA limits and do not have income restrictions.

2. As noted, Roth 401(k) contributions have no income restrictions. By contrast, Roth IRA contributions cannot be made directly if MAGI exceeds a certain dollar limit (for 2021, the phase-outs are \$198,000- \$208,000 for married couples filing jointly and \$125,000-\$140,000 for single filers).
3. Matching contributions. Many 401(k) plans match Roth 401(k) contributions, but there is no comparable bonus for making Roth IRA contributions.
4. Loans and life insurance available. 401(k) plans often allow loans. Roth IRAs (like traditional IRAs) cannot offer loans and cannot be invested in life insurance.
5. Age-55 10% early distribution penalty relief. Roth 401(k) distributions made after separation from service are exempt from the 10% early distribution penalty if separation occurs in the year the employee turns age 55 or older. This age-55 exception does not apply to Roth IRAs.

So, the answer? It depends. Of course!

**As always, if you have any questions or would like to learn more, please contact Steve Shane at [sshane@offitkurman.com](mailto:sshane@offitkurman.com) or [301.575.0313](tel:301.575.0313).**