Tax Benefits of Your Retirement Plan

Taxes can take a big bite out of your total investment returns, so it's encouraging to know that your employer-sponsored retirement savings plan may offer a variety of tax benefits. Depending on the type of plan your employer offers, you may be able to benefit from current tax savings.

Traditional/Pre-Tax: For those who want lower taxes now

With pre-tax contributions, the money is deducted from your paycheck before taxes, which helps reduce your taxable income and the amount of taxes you pay now. In addition, any earnings made on pre-tax contributions grow on a tax-deferred basis. That means you don't have to pay taxes on any gains each year as you would in a taxable investment account.

However, those tax benefits won't go on forever. Any money withdrawn from a tax-deferred account is subject to ordinary income taxes, and if the withdrawal takes place prior to age 59½ (or in some cases, age 55), you may be subject to a 10% penalty on the total amount of the distribution, unless an exception applies.

Tax break now

Traditional/Pre-Tax
You get your tax break up front and pay no taxes on the money you put in until you withdraw it.

Roth: For those who prefer tax-free income later

On the other hand, Roth contributions offer different benefits. Roth contributions are considered "after-tax," so you won't reduce the amount of current income subject to taxes.

However, distributions of Roth contributions are always tax-free because they were made on an after-tax basis. And distributions of earnings on those contributions are tax-free as long as they're qualified. Nonqualified distributions of earnings are subject to regular income taxes and a possible 10% penalty tax. If, at some point, you need to take a nonqualified withdrawal from a Roth account — due to an unexpected emergency, for example — only a portion of the total amount representing earnings will be taxable.

Tax break later

Roth
The money you deposit has already been taxed. You pay no taxes when you make withdrawals after age 59½.

*457(b) Plans do not incur the additional 10% penalty (but applicable taxes would apply).

Choosing Traditional or Roth

The decision of whether to contribute Pre-Tax or Roth depends on your personal situation. If you think you'll be in a similar or higher tax bracket when you retire, you may find Roth contributions more appealing since qualified income from a Roth account is tax free.

However, if you think you'll be in a lower tax bracket in retirement, then contributing to a traditional pre-tax account may be more appropriate. A tax advisor can help you decide.

Note: Not all employer plans qualify for Roth contributions. If your Employer offers Roth contributions on your Plan please visit www.tcgservices.com/documents.

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