

Ways to “Supercharge” Your 401(k)

By Dan Park and Cheryl Donaldson

A recent [article](#) in Forbes provides a good introduction to the power of the 401(k) in a traditional sense. Much of what it says is true: “contributing more now to your 401(k) can help you reach financial freedom faster” and “the faster you reach your retirement nest egg goal, the earlier you can potentially retire.” Indeed, maximizing pre-tax contributions throughout one’s working life is certainly a good start to a comfortable retirement.

However, there are other ways to “supercharge” your 401(k) that are not covered in this article.

A traditional pre-tax dollar funded 401(k) will grow tax-free over its lifetime, but a factor that is often overlooked is the loss of the benefit of long-term capital gains treatment on the underlying investments. When distributions are ultimately taken from the 401(k), the taxpayer must pay ordinary income tax on the entire amount, even on earnings attributable to long term assets. This means that an individual could potentially pay the highest marginal rate on retirement distributions in the future.

Without a crystal ball to forecast where the rates will go, there is a possibility that the tax savings at today’s marginal rates will be partially eclipsed by much higher tax rates in the future. Enter the Back Door Roth. While this strategy is still available under current tax law, some clients may wish to consider maximizing after tax contributions to their 401(k)s if their companies offer the option and allow in-service distributions.

In the optimal scenario, those after-tax contributions can be rolled over to a Roth IRA, a choice that provides greater flexibility in investment allocations as well as the benefit of tax-free withdrawals in the future. As a result, the uncertainty of future tax rate increases becomes far less consequential.

In addition, Roth IRAs offer greater flexibility for estate planning because, unlike traditional IRAs and 401(k)s, Roth IRAs are not subject to required minimum distributions. Therefore, the retiree has full discretion on how much will be distributed and when, or if any distributions will be made at all. If the funds are not needed, then the Roth IRA can be left to their beneficiaries.

As with any retirement plan strategy, there are additional factors to be considered before taking this approach. Cerity Partners advisors can assist with the appropriate analysis and execution for clients who are eligible to take advantage of this tax planning benefit.

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