July 18, 2023

Financial Planning Update

In December 2022, Congress passed new rules for the catch-up provisions for 401(k) plans. Currently, employees 50 or older can contribute an extra $7,500 into their accounts as a catch-up contribution for a total of $30,000 this year.

Starting in 2024, the catch-up funds will be required to go into after-tax ROTH accounts for those who earned more than $145,000 the previous year. The normal contribution amount of $22,500 will remain unchanged for 401(k) plans. It is just the catch-up contribution that will change.

The catch-up money will be taxed up front for employees at their current tax rates which can be their high earning years rather than in retirement when a typical retiree would be in a lower tax bracket.

Making catch-up contributions with pretax money has been advantageous for high earners. For example, someone in a 32% bracket would receive a $2,400 tax deduction for a $7,500 catch-up contribution, while someone in the 24% bracket would deduct $1,800.

Although some Americans will pay more in taxes under the new rules, we believe there is a benefit to contributing after-tax dollars to a ROTH, where money grows tax-free and can be withdrawn tax-free. The changes don't apply to IRAs, which allow a catch-up contribution in 2023 of $1,000 for savers 50 and over on top of the $6,500 annual limit.

There is also no required minimum distribution for ROTHs which can be beneficial for retirees later in retirement if they do not need the funds from their ROTH to fund their lifestyle.

Benefits of Roth

Retirees with traditional retirement accounts must pay ordinary income tax when they withdraw the money. In Roth accounts, workers can build an account consisting of tax-free money to spend in years in while dipping into tradition retirement accounts would push them into a higher tax bracket.

Higher earners often have large balances in their traditional retirement account like 401(k) and IRAs. At age 73, the IRS requires distributions from these accounts which may also push them into a higher tax bracket.

ROTHs are very attractive for savers also. A traditional taxable brokerage account would require the owner to pay taxes on the interest, dividends and capital gains from the account each year. The ROTH allows those funds to grow tax-free and upon death the ROTH is inherited tax free by the beneficiaries.

Both Roth and traditional accounts must be liquidated over 10 years by most non-spouse beneficiaries.

Many companies are now scrambling to be compliant with the new rules for 2024 and several have requested more time from Congress. The Treasury Department has said that it plans to issue guidance in the near future.

3715 Northside Pkwy NW, Building 400-775, Atlanta, Georgia 30327