Roth vs. Traditional Investment

This is an ***example*** of how personal contributions to a retirement account can provide tax savings under either pre-tax or a post-tax Roth Account.

	Contributes to a Roth Account	**Contributes to a Traditional TDA**
Annual Income	$30,000	$30,000
Pre-Tax Retirement Contributions	$0	$6,000 ($500/month)
Taxable Income	$30,000	$24,000
Federal taxes paid annually*	$7,500*	$6,000*
Post-Tax Retirement Contributions	$6,000 ($500/month)	$0
Pay after Federal Taxes	16,500	18,000
Total Retirement Savings After 30 Years**	$474,349**	$474,349**
Federal taxes owed at withdrawal*	$0	$71,152*
Take-Home Retirement Savings	$474,349	$403,197

*Based on a federal tax withholding rate of 25% while working and 15% in retirement.
**Based on a contribution rate of $6,000 per year, and 6% annual return rate.

The individual who contributed to a traditional pre-tax account saved $45,000 in taxes over 30 years ($7,500-$6,000= $1,500 * 30 years). However, at retirement this individual will owe $71,152 in taxes on their retirement income. Over a lifetime, the individual who contributed to the Roth account will have paid $26,152 ($71,152-$45,000) less in taxes, and will have a smaller tax obligation in retirement.

Why would an individual contribute to a pre-tax as opposed to a Roth account?

In this example, contributing to the traditional pre-tax account saves $1,500 per year ($125 per month), which is additional disposable income. These immediate tax savings may have been the reason the individual could afford to contribute $500 per month.

Another example: if this individual could not afford to have disposable income of less than $18,000 per year, which equates to contributing $375 per month into a Roth account, the total retirement savings after 30 years would be more than $120,000 less than someone who had put aside $500 per month. This additional money is significant when compounding interest is factored in the equation. The additional savings made possible by using pre-tax dollars is significantly more than the taxes owed in retirement for this individual.

What are your circumstances?

Obviously, there are many factors to consider when deciding whether to invest in a Roth or traditional pre-tax account. Your current tax rate and your anticipated tax bracket in retirement, the amount you can afford to contribute under each kind of plan, the number of years you have until retirement, and other factors all alter the figures for your situation. Contact a TIAA professional, or a financial advisor, to help you determine the best investment option for you.