

Roth Basics in 403(b) and 457(b) Plans

Presented by PenServ Plan Services



What is Roth?

- ▶ **Roth refers to a contribution type that is After-Tax** *(in contrast to traditional pre-tax contributions)*
 - ▶ Roth Contributions distributed tax-free
 - ▶ Earnings distributed tax-free if qualified
 - ▶ Funded for at least 5 years

Both the Plan Document and Investment Provider must allow Roth Contributions for employees to make Roth deferrals.



How much can be contributed?

- ▶ Rules vary by plan type
 - ▶ For a **Roth IRA accounts** how much you can contribute is affected by your modified AGI (adjusted gross income) and tax filing status, the max basic limit for eligible participants can defer to a Roth IRA is \$7,500 in 2026.



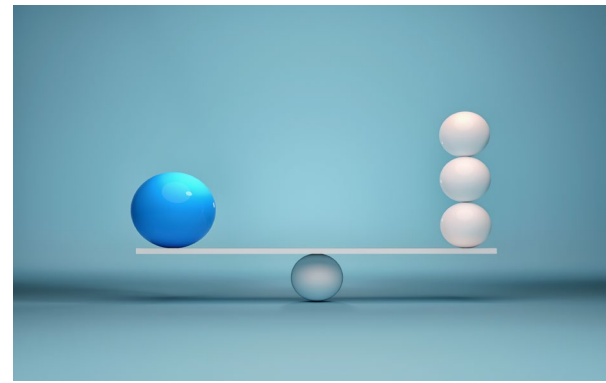
403(b) and 457(b) Elective Deferral Limits

In 2026, the basic limit is \$24,500

- Applies to aggregate of pre-tax and/or Roth deferrals
- If both plans are offered, you can max out in both
- Additional catch-ups available
- **No AGI impact to your ability to make elective deferrals to a 403(b) or 457(b)**



Roth Strategies: Pay taxes now or later?



Pre-tax Deferrals

- ▶ No taxes at deferral
- ▶ Taxes apply at distribution

Roth Deferrals

- ▶ Pay tax now at deferral
- ▶ Contributions distribute tax-free
 - ▶ Earnings distribute tax-free if qualified (meaning Roth account funded for at least 5 years)

Note: A mixture may allow for flexibility in taxable income



Distribution Strategy in Retirement

- ▶ In a **higher income years, distribute Roth** assets to avoid increasing taxable income
- ▶ In a **lower taxable income years, distribute Pretax** when taxation on that income is at preferable rate

Note: You may wish distribute a mixture of Pre-tax and Roth as it fits your unique tax circumstances.



**Which is better,
Pretax or Roth?**



Example 1

Equal Taxation at Deferral and Distribution

	Pre-tax	Roth
Annual Investment	\$4000	\$3000
Annual Tax Savings at <u>Deferral</u> (25% bracket)	\$1000	\$0
Net Pay Impact	-\$3000	-\$3000
Future Account Value before taxation	\$155,971	\$116,978
Future Account Value at <u>Distribution</u> after taxes <i>(Assumptions: 20 years at 6% earnings, assuming 25% tax bracket)</i>	\$116,978	\$116,978

***If the deferrals and distributions are taxed at the same tax rate,
you get to the same place in terms of account value.***



Example 2

Higher Taxes at Distribution

	Pre-tax	Roth
Annual Investment	\$4000	\$3000
Annual Tax Savings at <u>Deferral</u> (25% bracket)	\$1000	\$0
Net Pay Impact	-\$3000	-\$3000
Future Account Value before taxation	\$155,971	\$116,978
Future Account Value at <u>Distribution</u> at a higher rate (Assumptions: 20 years at 6% earnings, assuming <u>30% tax bracket</u>)	\$109,180	\$116,978

*If taxation is higher at distribution than deferral,
Roth has the advantage.*



Example 3

Lower Taxes at Distribution

	Pre-tax	Roth
Annual Investment	\$4000	\$3000
Annual Tax Savings at <u>Deferral</u> (25% bracket)	\$1000	\$0
Net Pay Impact	-\$3000	-\$3000
Future Account Value before taxation	\$155,971	\$116,978
Future Account Value at <u>Distribution</u> at a lower rate (Assumptions: 20 years at 6% earnings, assuming <u>20% tax bracket</u>)	\$124,777	\$116,978

*If taxation is lower at distribution than at deferral,
Pre-tax has the advantage.*



Pre-Tax vs. Roth in 403(b) and 457(b) Plans

	Pre Tax	Roth
<i>Taxed at time of deferral</i>	No	Yes, reported on W2 from the Employer as taxable income
<i>Taxation on contributions when distributed</i>	Yes, reportable on 1099R from the Investment Provider as taxable income	No
<i>Taxation on earnings when distributed</i>	Yes, reported on 1099R from the Investment Provider as taxable income	No, if the account is qualified*
Subject to RMD	Yes	No

* Roth account must have been open and received first contributions 5 years ago or more for distributions to be considered qualified





Critical Roth Reminders

- ❑ *Act early. Keep the 5-year rule in mind.*
- ❑ *Be sure the account can accept Roth Contributions.*
- ❑ *403(b) and 457(b) contributions can start, stop, or be modified at any time in most plans*
- ❑ *Monitor your paycheck and your account*
- ❑ *Communicate any issues/questions as soon as possible to PenServ, your provider, or your employer.*



Resources

Speak to your tax advisor and/or investment professional regarding your investment choices and taxation strategies.

- **Investor.gov**: *Information on terminology, types of investments, understanding fees, risk, advisor qualifications, and calculators.*
- **BrokerCheck.finra.org**: *This is a tool that allows you to view advisor qualifications and history for those marketing mutual funds.*
- **NMLScustomeraccess.org**: *This is a tool for looking up the state license for those advisors marketing annuities including qualifications and history.*
- **Sites for researching investment specifics**:
 - *403bCompare.com: CALSTRs easy to use site for comparing vendors*
 - *SPGlobal.com (Standard and Poors) and Moodys.com: Ratings and investment insights*



Questions?
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