

Decisions, Decisions: Choosing Among Retirement Plan Contribution Types



If your employer-sponsored 401(k) or 403(b) plan offers pre-tax, Roth, and/or non-Roth after-tax contributions, which should you choose? How do you know which one might be appropriate for your needs? Start by understanding the features of each.



Pre-tax: For those who want lower taxes now

Beginning in 2026, individuals earning more than \$150,000 will be required to make catch-up contributions on a Roth basis.

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. Consider the following example, which is hypothetical and has been simplified for illustrative purposes.

Example(s): Frank earns \$2,000 every two weeks before taxes. If he contributes nothing to his retirement plan on a pre-tax basis, the amount of his pay that will be subject to income taxes will be the full \$2,000. If he was in the 22% federal tax bracket, he would pay \$440 in federal income taxes, reducing his take-home pay to \$1,560. On the other hand, if he contributes 10% of his income to the plan on a pre-tax basis — or \$200 — he would reduce the amount of his taxable pay to \$1,800. That would reduce the amount of taxes to \$396. After accounting for both federal taxes and his plan contribution, Frank's take-home pay would be \$1,404. The bottom line? Frank would be able to invest \$200 toward his future by reducing his take-home pay by just \$156. That's the benefit of pre-tax contributions.

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 Any money withdrawn from a tax-deferred account is subject to ordinary income taxes, and if the withdrawal takes place prior to age 59½ (or in some cases, age 55), you may be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.

Roth: For those who prefer tax-free income later

On the other hand, contributing to a Roth account offers different benefits. Roth contributions are considered "after-tax," so you won't reduce the amount of current income subject to taxes. But qualified distributions down the road will be *tax-free*.

A qualified Roth distribution is one that occurs:

- After a five-year holding period and



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- Upon death, disability, or reaching age 59½

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 the pro-rata portion of the total amount representing earnings will be taxable.

Example(s): *In order to meet an unexpected emergency financial need of \$8,000, Holly decides to take a nonqualified hardship withdrawal from her Roth account. Of the \$20,000 total value of the account, \$18,400 represents after-tax Roth contributions and \$1,600 is attributed to investment earnings. Because earnings represent 8% of the total account value ($\$1,600 \div \$20,000 = 0.08$), this same percent of Holly's \$8,000 distribution — or \$640 ($\$8,000 \times 0.08$) — will be considered earnings subject to both income taxes and a 10% potential penalty tax.*

Keep in mind that tapping your account before retirement defeats its purpose. If you need money in a pinch, try to exhaust all other possibilities before taking a distribution. Always bear in mind that the most important benefit of a Roth account is the opportunity to build a nest egg of tax-free income for retirement. Finally, not all plans allow in-service withdrawals.

After-tax: For those who are able to exceed the limits

Finally, some 401(k) and 403(b) plans allow you to make additional, non-Roth after-tax contributions. This plan feature helps those who want to make contributions exceeding the annual total limit on pre-tax and Roth accounts (in 2026, the limit is \$24,500; \$32,500 for those age 50 to 59 or 64 and older; \$35,750 for those who reach age 60 to 63 in 2026).¹ As with a traditional pre-tax account, earnings on after-tax contributions grow on a tax-deferred basis.

If this option is offered (check your plan documents), keep in mind that total employee and employer contributions cannot exceed \$72,000; \$80,000 for those age 50 to 59 or 64 and older; or \$83,250 for those age 60 to 63 (2026 limits).

Another benefit of making after-tax contributions is that when you leave your job or retire, they can be rolled over tax-free to a Roth IRA, which also allows for potential tax-free growth from that point forward. Some higher-income individuals may welcome this potential benefit if their income affects their ability to directly fund a Roth IRA. [In addition to rolling the proceeds to a Roth IRA, you may also (1) leave the assets in the original plan (if allowed), (2) transfer assets to a new employer's plan (if allowed), or (3) withdraw the funds.]²

Which to choose?

Determining which types of plan contributions to make is a strategic decision based on your household's needs and tax situation. Because non-Roth after-tax contributions are generally most appropriate only to those who wish to exceed the contribution limits on pre-tax and/or Roth accounts, it may be best to focus on maxing out those accounts first.

If your plan offers both pre-tax and Roth contributions (check your plan documents), the general rule is to consider whether you will benefit more from the tax break today than you would in retirement. Specifically, if you think you'll be in a higher tax bracket in retirement, Roth contributions may be more beneficial in the long run.

Also, regardless of whether you choose pre-tax or Roth contributions, be sure to strive for contributing at least enough to receive any employer match that may be offered. Matching contributions represent money that your employer offers to help you pursue your savings goal. If you don't contribute enough to take advantage of the full amount of the match, you are essentially turning down free money.³

Once the annual contribution limit has been reached for pre-tax and/or Roth contributions, it may be time to consider non-Roth after-tax contributions if your plan permits them.

For more information specific to your situation, consult a qualified tax professional. (Working with a tax professional cannot guarantee financial success.)

¹ Section 403(b) plans may allow employees with 15 or more years of service to make special catch-up contributions in addition to the age 50 catch-up contribution. Under this special rule, the maximum additional catch-up contributions in any year is \$3,000 and the lifetime aggregate special catch-up contribution is \$15,000.

² Keep in mind that distributions of earnings on non-Roth after-tax contributions will be subject to regular income taxes and possibly penalty taxes if the money is not rolled over to a traditional IRA. IRS Notice 2014-54 clarifies the rules regarding rollovers of non-Roth, after-tax plan contributions to a Roth IRA.

³ Employer matching contributions may be subject to a vesting schedule, through which plan participants earn rights to the employer contributions, and earnings on those contributions, over a period of time. Employer matching contributions are not offered in all plans. Check your plan documents.

This content has been reviewed by [FINRA](#).

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