Understanding Roth 401(k)s: A Guide for Physicians

As a high-earning physician, you face unique hurdles when preparing for retirement. To maintain your elevated lifestyle post-working, you must establish a robust retirement income strategy and save diligently. Simply maxing out your traditional 401(k) contribution limits isn't enough, and it doesn't provide the attractive tax benefits of after-tax savings like a Roth IRA (which you may not be eligible to use).

Enter the Roth 401(k) — a lesser-known savings vehicle that your hospital network may offer employees (though you'll want to check with your human resources department to confirm).

In this guide, we're reviewing what a Roth 401(k) is, who's eligible to contribute to one, and how it compares to other popular retirement savings vehicles.

What Is a Roth 401(k)?

Roth contributions to a 401(k) work much like they would with a Roth IRA. The account is funded with after-tax dollars. While that means contributions don't lower your taxable income for the year they're made, you get to enjoy tax-free withdrawals in retirement on both the principal contributions and any growth in the account.

Contribution Limits for 2024

Contribution limits reset at the beginning of the calendar year, meaning you must get your annual contributions into your Roth 401(k) by December 31. If you exceed the annual contribution limit, you risk tax penalties on the excess amount, so keep a close eye on your contributions. If you do find that you've overcontributed to your Roth 401(k), work with your advisor, human resources department, and tax professional to remedy the situation promptly.

2024 employees can contribute up to $23,000 to their Roth 401(k). If you're over 50, you may contribute an additional $7,500 — for a total of $30,000.[1]

It's important to note that a Roth 401(k) is a part of your defined benefits plan, which means it counts toward your defined benefit plan annual contribution limits. All contributions for 2024, including employer matching, cannot exceed $69,000 or 100% of your compensation, whichever is lower. Again, if you're over 50, that limit bumps up to $76,500.[2]

Here's why that's important:

Say you max out your 401(k) contributions at $23,000 in 2024 (note that traditional contribution limits are the same as Roth limits). Your employer matches 50% ($11,500), bringing your total up to $34,500. That means in your Roth 401(k) bucket, you and your employer can contribute what's left after deducting $34,500 from the $69,000 limit. In this case, it's another $34,500.

How to Take Tax-Free Distributions

To take advantage of tax-free distributions from your Roth 401(k), you must meet two primary criteria:[3]

- You've been contributing to the account for at least five years.
- You're over the age of 59 ½.

If you do not meet these criteria but become disabled, you may be able to take tax-free withdrawals as well.

If you take a withdrawal and do not meet the criteria for a "qualified" withdrawal, you may be required to pay both income taxes and a 10% tax penalty on at least a portion of the withdrawal.

Roth 401(k) vs. Traditional 401(k)

Your hospital system likely offers you a defined contribution plan, like a 401(k) or 403(b). With a traditional account, you elect to remove money from your paycheck via payroll deferrals before taxes and contribute those funds directly into the account.

You can deduct contributions to a traditional 401(k) or 403(b) from your taxable income. Not only can this help reduce your tax liability for the year contributions are made, but it may make you eligible for additional tax credits and deductions.

The money grows tax-free, and when it's time to withdraw, the distributions are taxable as ordinary income.

The biggest takeaway is that withdrawals from your traditional 401(k) are taxed as ordinary income in retirement, whereas withdrawals from your Roth account are tax-free.

Roth 401(k) vs. Roth IRA

While Roth 401(k)s and Roth IRAs include similar tax benefits, like tax-free distributions in retirement, they do have some distinct differences to keep in mind.

Contribution Limits

While Roth IRAs are excellent savings vehicles, their contribution limits have historically been significantly lower than the contribution limits of defined benefit plans like 401(k)s. 2024, for example, the contribution limit for Roth IRAs was $7,000 (or $8,000 for those over 50).[1] Again, contribution limits for Roth 401(k)s mirror those for traditional 401(k)s, which in 2024 was $23,000 — more than three times the Roth IRA limit.

Income Restrictions

Roth IRAs have income restrictions, meaning high-earners may be limited to contributing less (or nothing altogether) depending on their adjusted gross income (AGI) for the year. This can also cause issues if your income is under

the income limit, but you marry a fellow physician — meaning your combined income now pushes you above the Roth IRA limit.

However, a Roth 401(k) has no income limits. As long as you're eligible to contribute to your company's 401(k) — and they offer a Roth option — you can contribute after-tax dollars to the Roth 401(k).

Keep in mind, however, that there are ways to get around Roth IRA income limits. A backdoor Roth IRA, for example, enables you to fund a traditional IRA and convert all or a portion of it into a Roth IRA. Remember that there are some tax consequences to consider, and this strategy isn't the best fit for everyone. Consult with a financial or tax professional before pursuing this type of strategy.

Roth 401(k) vs. After-Tax 401(k)

The term "after-tax" may sound interchangeable with Roth in this context, but there's a difference between the two.

Think of after-tax contributions as an expansion on your regular pre-tax contributions. Once you max out contributions to your traditional 401(k), you can make additional contributions using after-tax dollars. As mentioned, after-tax contributions will go toward your total annual defined plan contribution limits ($69,000 in 2024).

If you're looking to stash more savings away for retirement beyond the typical 401(k) limits, after-tax dollars may be a viable option. However, they differ from Roth 401(k) contributions — which offer more tax benefits.

Any growth earned on your after-tax contributions is tax-deferred. In other words, while the principal amount you contributed using after-tax dollars can be withdrawn tax-free, you're still on the hook for paying tax on the earnings. By comparison, qualified withdrawals from your Roth 401(k) are entirely tax-free (including principal contributions and growth).

Recent Changes to Roth 401(k) Rules for Employees

At the end of 2022, Congress passed additional retirement reforms designed to expand changes made in 2019's Setting Every Community Up for

Retirement Enhancement (SECURE) Act. This reasonably new legislation, the SECURE Act 2.0, included changes to Roth 401(k)s.

Employers have traditionally been able to make matching contributions to employee Roth 401(k) accounts, though these contributions had to be with pre-tax dollars. But with the passing of SECURE 2.0, employers can match contributions to Roth accounts, giving employees an extra retirement tax advantage.

In addition, Roth 401(k)s will no longer have required minimum distributions (RMDs) beginning in 2024.

When Is a Roth 401(k) Beneficial?

There are a few specific circumstances in which a Roth 401(k) can be especially appealing for doctors and physicians.

Your Tax Rate Is Expected to Stay the Same

If you expect your retirement tax rate to be the same or higher than your current tax rate, then a Roth 401(k) may be advantageous. In general, Roth accounts are ideal for those who anticipate retiring in a higher tax bracket than the one they're currently in. If you can pay taxes on those contributions now while in a presumably lower tax bracket, you can keep more of your money in retirement.

Even if you're in a reasonably high tax bracket now, no one knows what the tax rate will be like — especially if retirement is still decades away. If you want to ease the financial stress for your future self, taking care of the tax obligation now could give you a significant boost later on when it matters most.

If you're an early-career physician, it's possible (even likely) that you're earning less now than when you enter retirement. So, contributing to a Roth account could be a benefit in the long run. Even though you'll pay taxes now, it will be at a lower rate than you anticipate paying in the future.

But if you're a physician in your peak earning years, you could earn less (hence be in a lower tax bracket) come retirement. A traditional 401(k) could make more sense if this is the case.

You're Planning to Transfer Wealth to Your Loved Ones

Roth accounts can make an excellent addition to your estate plan. Based on current law, your heirs won't have to pay income tax on any distributions from the account.

The IRS allows heirs to transfer the money from a Roth 401(k) directly into an Inherited Roth IRA. While they will need to take RMDs from this account, they should be tax-free distributions so they won't negatively impact your beneficiary's tax situation.

Disadvantages of a Roth 401(k)

As with any other retirement savings vehicle, a few potential disadvantages exist before contributing to a Roth 401(k).

Won't Lower Your Immediate Tax Liability

Remember, your expected tax rate today versus in retirement should play a significant role in your decision to use a Roth or traditional savings account.

If your effective tax rate remains the same or decreases in the future, a traditional 401(k) account may be a better move. Contributions to a traditional account will lower your taxable income for the year you make them. This process can have a domino effect on other areas of your financial life, such as capital gains tax rates, net investment income tax, and the availability of certain tax credits or deductions.

If you're retired already, lowering your taxable income for the year can be essential to your Medicare premiums and Social Security taxes.

Less Flexibility

It can be challenging to access your 401(k) before retirement, and doing so can incur severe penalties, which reduce your retirement savings. Investing in a Roth IRA or brokerage account may provide more flexibility if you believe you'll need the money from these accounts before you turn 59 ½.

If you are under 59 ½, there are certain circumstances in which you can access the money in your Roth IRA account without incurring taxes. These include:[4]

- Purchasing your first house (up to $ 10,000-lifetime maximum)
- Covering qualified education expenses

- Paying for expenses related to birth or adoption
- Becoming disabled or dying
- Paying for unreimbursed medical expenses or health insurance (if unemployed)

It’s important to note that if you make a qualifying withdrawal for any of these reasons, you may still incur a penalty if the Roth IRA is less than five years old.

Fewer Investment Options

While it may not matter to everyone, a 401(k) tends to offer fewer investment choices because you’re typically restricted by what your employer offers. If individualizing your investment options is essential, an IRA will offer much more flexibility.

Should You Contribute to a Roth 401(k)?

If your hospital network offers the option to contribute to a Roth 401(k), it’s certainly an option to consider — especially if they do employer matching. The excellent news is that retirement savings vehicles are not mutually exclusive

They’re designed to work together to help you increase your savings for retirement and diversify the tax treatment of your future income. You certainly don’t have to pick and stick to one type of account forever. Since each comes with unique benefits and drawbacks, contributing to a combination of accounts can help you create well-balanced savings

If you have any questions about your retirement savings strategy or want to learn more about how we help families like yours prepare for retirement, feel free to schedule a time to talk with our team.