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Your Guide to Roth 457(b) Contributions

By now, you may have heard of the Roth IRA. You may have even set one up. Well, you also have the opportunity to designate all or part of your contributions to your governmental deferred compensation plan as after-tax Roth 457 contributions.

When you contribute to a Roth 457, you pay taxes on the portion of your salary that goes into the plan; but withdrawals of contributions and earnings can be tax-free during retirement if certain conditions are met.[1]

If you wish, you can even split your contributions between traditional, pre-tax 457 contributions and Roth 457 contributions.

What's the benefit of designating some or all of your contributions as Roth? It gives you the opportunity to pay taxes on your contributions now and avoid taxes later.

Let's compare

	Traditional (pre-tax) 457(b)	Designated Roth 457 (Current Tax Bracket: 15%)	Designated Roth 457 (Current Tax Bracket: 25%)	Designated Roth 457 (Current Tax Bracket: 35%)
Single contribution	$10,000	$10,000	$10,000	$10,000
Less federal taxes paid on contribution	$0	$1,500	$2,500	$3,500
Net total contribution	$10,000	$8,500	$7,500	$6,500
Value in 20 years	$46,610	$39,618	$34,957	$30,296
Less federal taxes at distribution (25% tax bracket)	$11,652	$0	$0	$0
Net distribution	$34,957	$39,618	$34,957	$30,296

These examples are hypothetical in nature and assume a 25% tax bracket at distribution. It also assumes that the retirement plan's value earns an average total return of 8% compounded annually. Investment return is not guaranteed and will vary depending upon the investments and market experience.

A single contribution of $10,000 will be worth the same amount in 20 years if the tax bracket remains the same.

However, if the future tax rate is greater, the amount distributed from the Roth account could be greater than the pre-tax amount distributed from the traditional 457(b) account.

What's the difference?

	Traditional (pre-tax) 457(b)	Roth 457	Roth IRA
2012 contribution limit	Combined $17,000		$5,000
2012 catch-up contribution limit—for those age 50 and older	Combined $5,500		$1,000
Contribution taxable in year contributed	No	Yes	Yes
Contribution taxable in year distributed	Yes	No	No
Contribution earnings taxable in year distributed	Yes	No[1]	No[1]
Your income determines your contribution amount	No	No	Yes

Source: IR-2011-103: IRS Announces Pension Plan Limitations for 2012, 10/20/2012

Is a Roth 457 right for you?

You may want to consider making Roth 457 contributions if you:

- Believe that taxes will be raised before you retire and you want to take advantage of the potential tax-free withdrawals provided for with a Roth 457 account
- Expect to be in a higher tax bracket upon retirement
- Are younger, with many working years ahead of you
- Are unable to contribute to a Roth IRA because of your income
- Are looking for an estate-planning tool to leave assets tax-free to heirs

Ready to learn more?

If you decide contributing to a Roth 457 account makes sense for you, we're here to help. Call me today!

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[1] Contributions and earnings from a Roth are not taxable if the distribution is made after five consecutive tax years since the first Roth contribution was made AND the distribution is made after age 59½, or because of death or disability, or a qualified first-time home purchase for Roth IRA.

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NRM-8237AO.2 (01/12)

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