KEY TRADEOFFS OF MAKING ROTH 401(K) CATCH-UP CONTRIBUTIONS VS. INVESTING THAT EXCESS INCOME IN A TAXABLE BROKERAGE ACCOUNT

INTRODUCTION

In November ‘25, I posted an article summarizing Retirement Plan Changes for 2026, which is listed in the Resources section at the end of this article. This new article is a complement to the November article and offers additional insight related to the new rule for Catch-Up Contributions for High Earners. This new rule states that:

> *For participants aged 50 and over who earned more than $150,000 in FICA (Social Security) wages in the prior year, any catch-up contributions made in 2026 and beyond must be made to a Roth 401(k)/403(b)/457(b) account (after-tax). The option for pre-tax Catch-Up contributions is eliminated for this group. If an employer's plan does not offer a Roth option, affected high-earning participants may be prohibited from making any catch-up contributions at all.*

Specifically, this article summarizes the tradeoffs of making the catch-up contributions into a Roth 401(k) account versus investing the catch-up contribution amount in a taxable investment account.

Both options are sound for retirement savings; the better choice depends on your investing discipline, taxation objectives, liquidity needs, and investment timeline.

TAXATION CONSIDERATIONS

Roth 401(k) Catch-Up

- Contributions are **after-tax** (you pay income tax now).
- Earnings grow **tax-free** and qualified withdrawals are **tax-free**.

Investing the Income (Taxable Account)

- Contributions are **after-tax** (you pay income tax now).
- Dividends, interest and Capital Gain Distribution earned on these investments are taxed annually.
- Capital gains tied to elective sales of assets are taxed when the invested assets are sold (at potentially favorable long-term capital gains rates).

Which Option is better? A Roth 401(k) has the advantage from a taxation perspective, as there will be no taxes owed on the investment returns as long as age and holding period requirements are met.

INVESTING AUTOMATION AND ACCESS TO FUNDS

Roth 401(k) Catch-Up

- Investments are made automatically via your employer’s payroll deduction process.
- You must be at least 59½ years old and have held the account for at least five years to take qualified withdrawals without taxes or penalties.
- If you need access to your Roth 401(k) funds before meeting the minimum age and holding period requirements, most plans allow you to take a loan from your 401(k) account.

Investing the Income (Taxable Account)

- These investments are not automated as part of your payroll processing; you will need to invest these assets on a regular basis via a different process.
- You have full access to these funds, with no age or holding period restrictions.

Which Option is better? I again give the edge to the Roth 401(k) option, based on the automated investing process. For high earners assessing these tradeoffs, I expect they have other assets to leverage so that they will be able to meet the age and 5-year holding period criteria for qualified withdrawals, so short-term access to the Roth 401(k) funds is not a significant decision factor.

INVESTMENT OPTIONS

Roth 401(k)s limit investments to plan offerings, while taxable accounts allow much broader investment choices and tax-loss harvesting potential.

Roth 401(k)

- Limited to your employer's plan options.
- May have lower institutional-based expense fees than the fees charged in private investing accounts.

Taxable account

- Full freedom: ETFs, individual stocks, bonds, real estate funds, etc.
- Investors can implement tax-loss harvesting strategies, if applicable.

Which Option is better? Taxable investment accounts have the advantage both in access to a much wider breadth of investment offerings than Roth 401(k) plans offer, and the potential to include these assets in a tax-loss harvesting strategy, if applicable.

ESTATE PLANNING

Roth 401(k)/Roth IRA

- Heirs inherit the tax-free growth potential of the Roth 401(k) and do not pay taxes on qualified withdrawals. However, non-spouse inheritors must withdraw the Roth 401(k) assets within a set period.

Taxable account

- Inheritors receive a step-up of the cost basis of inherited assets, eliminating immediate capital gains for heirs.
- Subsequent investment gains on the inherited assets will be taxed.

Which Option is better?
If maximizing tax-free earnings growth is a key goal, the Roth 401(k) extends this advantage to your heirs, giving the Roth 401(k) the edge related to Estate Planning benefits.

SUMMARY

Roth 401(k) catch-up contributions are generally better for long-term tax-free retirement income and passing the assets on to heirs with optimal tax efficiency. Taxable investing offers better access and investment choice. The right choice depends on your tax expectations, liquidity needs, and financial goals.

Roth 401(k) Catch-Up is Usually Better If:

✓ You want more tax-free income in retirement.

✓ You do not need the money before age 59½ or the 5-year holding period has elapsed.

✓ Your employer plan has solid, low-cost investments.

✓ You would like to reduce future tax complexity.

Investing the Income (Taxable) is Usually Better If:

✓ You want flexibility and access to the funds before retirement age.

✓ You want more investment choices.

✓ You plan to leverage tax-loss harvesting strategies.

BOTTOM LINE

There is no one-size-fits-all answer. As with other investment decisions, it is important to understand your specific situation regarding investment time horizon, tax planning and estate objectives. The main tradeoff when assessing these options for catch-up contributions is tax-free growth and retirement tax efficiency (Roth 401(k)) versus access flexibility and investing options (taxable).

RESOURCES

1. https://www.eustaceadvisors.com/files/eustace_advisors_article_20251130_retirement_plan_changes_for_2026.pdf.
2. https://retirable.com/advice/retirement-accounts/what-are-the-roth-401k-withdrawal-rules.
3. https://www.investopedia.com/ask/answers/101314/what-are-roth-401k-withdrawal-rules.asp.
4. https://irahelp.com/deciphering-the-rules-for-roth-401k-to-roth-ira-rollovers/.
5. https://www.franklintempleton.com/articles-us/retirement/secure-2-update-mandatory-roth-catch-up-contributions-arrive-in-2026.