the Pension Studio

Roth 401(k)

Pretax or after-tax? That is the question many employees are facing as more and more plans allow for Roth deferrals.

The Roth 401(k) gives employees the option of setting aside money from their paychecks that's already been taxed and saving it in a retirement account where it can grow tax-free. If you have a regular 401(k) or a regular Roth IRA, you'll still be able to contribute to both of those accounts; the Roth 401(k) is simply another option. A Roth 403(b) will also be available.

The Roth 401(k) is similar to the Roth IRA in that after-tax money is being saved and grows tax-free, but, as its name implies, the new account will fall under 401(k) rules. Some of the main features of how the Roth 401(k), as it stands now, will work.

- Employees will be able to contribute after-tax dollars to the Roth 401(k). The money will be held in a separate account from contributions to your regular 401(k). You decide what percentage of your retirement plan contributions go to either account.
- You'll be able to make the maximum contribution allowable under 401(k) rules. The 2008 401(k) contribution limits allow employees less than age 50 to sock away up to $15,500 -- $20,500 for employees age 50 or older. For those who want to save after-tax money, this is a much quicker route than saving in the Roth IRA, which has contribution limits of $4,100 for those less than age 50 and $6,000 for those age 50 and above in 2008. If you have a Roth IRA, or plan to open one, you can still contribute the maximum allowable to that account in addition to your Roth 401(k) contributions.
- If your company provides a matching contribution, it will be pretax money and will go only into the regular 401(k) account.
- The Roth 401(k) is open to all employees who qualify for the regular 401(k). This is a boon to higher-paid employees who may be excluded from having a Roth IRA account because of its income limitations.
- Contributions are irrevocable. Once the money goes into the account, it falls under all of the IRS rules and penalties for 401(k) accounts; you can't change your mind and have it switched over to your regular 401(k).
- Money can be withdrawn tax- and penalty-free as long as you're at least age 59½ and have held the account for at least five years.
- The Roth 401(k) has the same distribution requirements as the 401(k). You'll need to begin taking minimum distributions by the time you reach age 70½. This contrasts with the Roth IRA, which has no distribution requirements.
- You can roll over your Roth 401(k) contributions to a Roth IRA when you retire or if your employment is terminated.