

The Roth 401(k) plan

Most people are aware that the key difference between traditional IRAs and Roth IRAs is the timing of the tax benefit. Traditional IRAs will, for many taxpayers, yield an up-front tax deduction, with distributions taxed as ordinary income. Contributions to a Roth IRA are made with after-tax dollars rather than pre-tax dollars, but retirement distributions that occur five years or more after the account is created are completely tax free. In 2006, the concept of the Roth IRA was introduced to employers with 401(k) plans.

A short description

With a Roth 401(k) plan, or as IRS describes it, a "designated Roth contribution program," employees make contributions with after-tax dollars. Your employer may match the contributions in the same manner as with a traditional 401(k) plan. But the match must be designated as a pre-tax contribution to the employee's traditional 401(k) plan account. The investment choices available are likely to be the same for both kinds of plans.

The income from the investments in a Roth 401(k) account accumulates tax free. Distributions of amounts representing the employee's contributions may be withdrawn tax free as well. *All* distributions can be tax free once the employee has been a participant in the plan for at least five years and has reached age 59 1/2. The holding period starts on the first day of the first year for which the employee makes a contribution.

Roth 401(k) plan versus Roth IRA

Two features make the Roth 401(k) better than the Roth IRA for higher-income families. First, there are no income restrictions at all on who may contribute to the Roth 401(k). That's a major difference from a Roth IRA, which is unavailable to married couples filing joint returns if their adjusted gross income (AGI) exceeds \$169,000 and to singles whose AGI is over \$116,000.

Second, the contribution limit for Roth 401(k) plans is the same as it is for traditional 401(k) plans—far higher than it is for a Roth IRA. For 2008 the basic employee contribution limit is \$15,500, and those who will be 50 or older during 2007 may make an additional \$5,000 "make-up" contribution. The equivalent amounts for Roth IRA contributions, on the other hand, are \$5,000 and \$6,000.

Minimum distributions will be required from a Roth 401(k) when the employee reaches age 70½. However, a Roth 401(k) can be rolled over to a Roth IRA if the participant leaves the company, relieving the participant from the need to make minimum distributions.

Slow acceptance

Roth 401(k) plans have yet to pick up steam, reports the Profit Sharing/401(k) Council of America. Only 22% of 429 employers surveyed in early 2007 offered the plans to employees. When they were offered, only 8% of employees had signed up.

Perhaps this slow response can be attributed to the fact that, at first, Roth 401(k) plans were not a permanent option for employers as they are now. Many employee benefits are optimistic, believing that, in time, both employers and employees will come to embrace this new alternative to the traditional 401(k) plan.

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Any developments occurring after January 1, 2008, are not reflected in this article.