

# Roth rules

The 411 on the Roth 401(k) **By Robert E. Coode**

**F**or the first time this year, employers can offer a brand-new option to 401(k) plan participants — the ability to make Roth 401(k) contributions.

## What is a Roth 401(k)?

A Roth 401(k) is simply a traditional 401(k) plan that accepts Roth 401(k) contributions. Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA contributions. This means there's no upfront tax benefit, but if certain conditions are met, your Roth 401(k) contributions and all accumulated investment earnings on those contributions are free from federal income tax when distributed from the plan.

## Who can contribute?

Unlike Roth IRAs, where individuals who earn more than a certain dollar amount aren't allowed to contribute, you can make Roth contributions regardless of your salary level, as soon as you're eligible to participate. And while a 401(k) plan can require employees to wait up to one year before they become eligible to contribute, many plans allow you to contribute beginning with your first paycheck.

## How much can I contribute?

There's an overall cap on your combined pretax and Roth 401(k) contributions. In 2006, you can contribute up to \$15,000 (\$20,000 if you're age 50 or older) to a 401(k) plan. You can split your contribution any way you wish. For example, you can make \$8,000 of Roth contributions and \$7,000 of pretax 401(k) contributions.

## Can I also contribute to a Roth IRA?

Yes. Your participation in a Roth 401(k) plan has no impact on your ability to contribute to a Roth IRA. You can contribute to both if you wish (assuming you meet the Roth IRA income limits). You can contribute up to \$4,000 to a

Roth 401(k) vs. Roth IRA		
	Roth 401(k)	Roth IRA
Maximum contribution (2006)	\$15,000	\$4,000
Catch-up (2006)	\$5,000	\$1,000
Who can contribute?	Any eligible employee	Only if under income limit
Age 70½ required distributions?	Yes	No
Tax-free qualified distributions?	Yes, 5-year waiting period plus either 59½, disability, or death	Same, plus first time home-buyer expenses (up to \$10,000 lifetime)
Bankruptcy protection	Unlimited	At least \$1 million (total of all IRAs)

Roth IRA in 2006 (\$5,000 if you're age 50 or older).

## Should I make pretax or Roth 401(k) contributions?

When you make pretax 401(k) contributions, you don't pay current income taxes on those dollars (which means more take-home pay). But your contributions and investment earnings are fully taxable when you receive a distribution from the plan.

In contrast, Roth 401(k) contributions are subject to income taxes up front, but qualified distributions of your contributions and earnings are entirely free from federal income tax.

Which is the better option depends upon your personal situation. If you think you'll be in a similar or higher tax bracket when you retire, Roth 401(k) contributions may be more appealing, since you'll effectively lock in today's lower tax rates.

However, if you think you'll be in a lower tax bracket when you retire, pretax 401(k) contributions may be more appropriate. Your investment horizon and projected investment results are also important factors.

A financial professional can help you determine which course is best for you.

## What about employer contributions?

Your employer can match your Roth contributions, your pretax contributions or both. But your employer contributions are always made on a pretax basis, even if they match your Roth contributions. That is, your employer's contributions, and investment earnings on those contributions, are not taxed until you receive a distribution from the plan.

## What else do I need to know?

Employers aren't required to make Roth contributions available in their 401(k) plans. So be sure to ask your employer if it is considering adding this feature to your 401(k) plan.

Consult a financial services provider to determine which option is best for your situation.



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