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What is a Roth 401(k)? Is it Right for Me?

Elective deferral contributions to a traditional retirement plan are contributed on a pre-tax basis and help lower your current taxable income. Roth elective deferral contributions, however, are much like a Roth IRA in that contributions are made on an after-tax basis. Money in the Roth account and any earnings will be distributed tax-free if withdrawn after age 59½, death, disability and at the end of the five-year taxable period during which the participant's deferral is first deposited into the Roth 401(k) account (a.k.a. the Five Year Rule). A Roth 401(k) account can be rolled over to another plan that permits Roth 401(k) contributions or to a Roth IRA. If rolled into a Roth IRA, the tax-free nature remains and the money is not subject to the minimum distribution requirement at age 72 as in the Roth 401(k).

Who Would Likely Benefit?

- People who believe taxes will be greater in the future
- Young investors who believe they will be in a higher tax bracket in the future
- Investors who do not qualify for the Roth IRA due to income limit
- Low-income investors who are tax-exempt
- Investors who use Roth 401(k) as a planning tool in conjunction with traditional 401(k) plans
- Allows participants to hedge against risk of higher future tax rates

Who Would Likely Not Benefit?

- People certain that future tax rates will decrease
- People expecting to experience a significant drop in income upon retirement
- People with high temporary income
- People needing access to their funds within the first five years of deferrals

	Traditional 401(k)	Roth 401(k)
Tax Treatment of Deferrals	Before Tax	After Tax
Tax Treatment of Earnings	Tax deferred	Tax-free
Tax Treatment of Final Distributions	Taxable at ordinary income rates	Tax-free
402(g) Salary Deferral Limits	$22,500 (Traditional + Roth)	$22,500 (Traditional + Roth)
Catch Up Limit	$7,500 (Traditional + Roth)	$7,500 (Traditional + Roth)
Distribution Restrictions	Subject to 401(k) rules, qualified distribution	Subject to 401(k) rules, qualified distributions, and Roth 401(k) account must be open for five tax years

In summary, Roth 401(k) contributions have potential to allow individuals more flexibility in saving for retirement, whereby giving investors more control over the taxable alternatives. Three Bell Capital recommends a cautious approach when weighing the pros and cons.

Contact your financial professional at 401k@three-bell.com for more information on the Roth 401(k) and to better determine an appropriate course of action.