

Information Release

Roth 401(k), Roth IRA, What Is the Difference?

And What Is Best for Me?

National Association of Tax Professionals (NATP) Appleton, WI – Many people have heard of Roth IRA's, but now there's a new "Roth" in town -- the Roth 401(k). Since the majority of us are not financial gurus schooled in the ins and outs of savings plans, this may be a bit confusing. Roth IRA's and Roth 401(k)'s – what are the differences? And more importantly, how can you use them to maximize the benefits?

First, and most importantly, if eligible and able, taxpayers can have both a Roth IRA and a Roth 401(k) at the same time. For those who want to save after-tax money and can afford to do so, the Roth 401(k) is a much quicker way to save than the Roth IRA, but the best advice may be to maximize both.

Definitions, differences, and benefits of each:

Roth IRA – Roth IRA's (Individual Retirement Accounts) were introduced in 1998 as an additional means for personal retirement savings. Roth contributions consist of after-tax income, therefore, upon distribution, neither the dollars put in nor the earnings on savings will be taxed (further). Roth IRA's are limited to \$4,000 per year (or \$4,500 for taxpayers age 50 or over). However, if a single taxpayer makes over \$110,000 per year, or a married couple makes over \$160,000, they are not eligible to have a Roth IRA. Besides the tax savings benefits, advantages of a Roth IRA include no required minimum distribution and the ability to withdraw contributions at any time for any reason without tax and penalties. Roth IRAs are a very good means of savings for those who qualify.

Roth 401(k) – Roth 401(k)'s will be available after January 1, 2006, and until December 31, 2010, if employers choose to offer them. The single largest benefit to a Roth 401(k) is that they allow employees under age 50 to save up to \$15,000 per year (\$20,000 for those over age 50) in after-tax money in an account where it can grow tax-free. Required minimum distributions must begin by age 70 ½. Contributions to the Roth 401(k) are irrevocable and the account is subject to all IRS rules and penalties for a traditional 401(k) account. Money can be withdrawn tax- and penalty-free once you reach age 59 ½ and have had the account for at least five years. If you retire or are terminated from

employment, you can roll over your Roth 401(k) into a Roth IRA. Once the Roth 401(k) program ends, you cannot add any more funds to this account; however, they can remain in the plan until distribution.

For employers to offer Roth 401(k)'s, they will need to do additional accounting work to open a new account for each employee participating in order to keep employee after-tax contributions to the Roth 401(k) separate from employer pretax contributions to a traditional 401(k). In other words, the funds in the Roth 401(k) will be the funds you put in only (and their earnings); employers cannot match these contributions. Any employer-added funds (and their earnings) will be placed in the traditional 401(k).

Time will tell how employers decide to handle Roth 401(k)s. Will they go through the extra administrative work for a program that is set to expire in 2010? If you are interested in the Roth 401(k) savings opportunities, express your preferences to your employer.

For more information on this and other tax issues, consult a reputable tax preparer. Selecting the right tax professional will save you time, headaches, and oftentimes money. For more information please contact us at consultant@thepmgroupsc.com or phone us at (864) 233-0254

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