Considering a Roth 401(k)

A Roth 401(k) option has become a popular offering in many employer-sponsored retirement plans. Roth 401(k) contributions are made with *after-tax* dollars, but qualified distributions — including earnings — are *tax free* once certain conditions are met. Employees can contribute to a Roth 401(k) even if their income exceeds the limits for making contributions to a Roth individual retirement account (IRA).

The Rules

For favorable tax treatment, funds must remain in your Roth 401(k) account for at least five tax years. After the five-year requirement is met, withdrawals are tax free once you reach age 59½ or you become disabled or die. As with a traditional 401(k), you generally must begin taking annual required minimum distributions (RMDs) from a Roth 401(k) after you turn age 70½. You can avoid taking RMDs by rolling over your Roth 401(k) to a Roth IRA prior to that age.

Deferral Limits

The annual amount of salary that can be deferred to 401(k) plans is limited by the IRS. For 2020, the contribution limit is $19,500. If their plan allows, individuals age 50 or older may make an additional catch-up contribution of $6,500. If you have both a traditional and a Roth 401(k), the limits apply to your combined contributions. Additional plan limits may apply.

Employers can match Roth 401(k) contributions; however, matching funds must go into a pretax account and will be taxable, along with any earnings, at withdrawal.

Rollover Option

If your 401(k) plan has a Roth feature, you may be able to roll over some or all of the money in your 401(k) account to a Roth 401(k) account inside your plan. You'll owe income taxes on the transferred amount in the year of the transaction.