



Melody C. Rute

Considering the Roth 401(k) Plan: What you need to know

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It's hard to open a newspaper or a business journal today without seeing an article about the new retirement plan feature that became available January 1, 2006, called the Roth 401(k) deferrals. It's a feature that allows you to deposit after-tax compensation to your 401(k) plan, creating a tax-free retirement account for your future.

Should you participate in the Roth 401(k) option?

What are Roth 401(k) deferrals?

Traditionally, participants elect to defer compensation to a 401(k) plan on a pre-tax basis. Subsequently, at retirement, withdrawals are taxed as ordinary income. With the Roth 401(k) feature, participants are permitted to make after-tax contributions. The benefit is that the future distribution of these deferrals and earnings are made tax-free.

Who Benefits from this Option?

- Younger people with many years until retirement to accrue the tax-free earnings.
- Highly-compensated individuals who are unable to make Roth IRA contributions.

- Anyone expecting to be in a higher tax bracket at retirement than at present.
- People who want to avoid age 70½ minimum distribution rules.

What You Should Know About Contributions

- Any participant can defer; there is no income level preventing one from making Roth 401(k) deferrals.
- Both types of deferrals (pre-tax and after tax) can be offered in a plan.
- The maximum deferral limit stays the same regardless of the type of deferral made. The limit is \$15,000, plus \$5000 catch-up in 2006 (for those age 50 or over).
- Roth 401(k) deferrals are eligible for employer matching contributions.
- Present pre-tax deferral balances cannot be converted to Roth 401(k) balances.
- Roth IRA's may not be rolled into a Roth 401(k) plan.
- As of now, this provision is scheduled to end in 2010.

What You Should Know About Distributions

- Roth 401(k) account balances can only be withdrawn tax-free when two conditions have been satisfied: (1) the participant is age 59½, disabled, or dies and

(2) the contributions have been in the plan for 5 years. If these conditions are not met, the earnings distributed will be subject to regular income tax and possibly a 10% penalty tax.

- Roth 401(k) deferrals can be used for plan loans, in-service, and hardship withdrawals, at the plan sponsor's discretion. Some of these withdrawal options have specific restrictions and may result in a taxable distribution.
- Roth 401(k) accounts are subject to the Required Minimum Distribution (70½) rules unless rolled out to a Roth IRA.
- Roth 401(k) accounts can be rolled over to another Roth 401(k) plan or a Roth IRA.

How Do You Know which Option Is Best for You?

There are several variables you should consider. Your income tax rate, number of years to retirement, return on your investments, and the amount you defer all factor into your decision-making process. To help you make a decision, we would suggest that you visit www.svaplaners.com/learningcenter/rothcalc.aspx to see how the Roth 401(k) investment might benefit you. If you still have questions regarding the 401(k) Roth option, check with your investment management or retirement administration professional.

Based in Madison, Wis, Melody Rute is a fee-only financial consultant with SVA Planners Inc., Registered Investment Advisor. For more information, contact Wisconsin Medical Society Insurance and Financial Services, Inc., at 866.442.3810.

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