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A New Flavor For Retirement

**It's Called a Roth 401(k) Plan,
And It May Be Better for Some,
Like Younger Workers, Parents**

By **JEFF D. OPDYKE**
Staff Reporter of THE WALL STREET JOURNAL
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Get ready for yet another retirement-savings plan.

Come Jan. 1, a new entrant joins the list of options: the Roth 401(k). Workers considering this route must answer a simple question from Uncle Sam: Do you want to pay me now or pay me later?

Traditional 401(k) plans allow investors to sock away part of their income before it is taxed by federal, state or local authorities; the government takes its cut as retirees withdraw the money.

With Roth 401(k) plans, the money that is contributed is taxed now, but the withdrawals are tax-free.


So far, neither workers nor employers have shown much interest in the Roth plans. For workers, paying into a Roth 401(k) means less take-home pay than if they contributed a like sum to a traditional 401(k). For employers, offering the new plan means additional administrative chores.

Still, while Roth 401(k) plans aren't right for everyone, they are advantageous to lots of people in a variety of situations, including younger workers, folks with big estates to leave their heirs and even parents and grandparents saving for children's college education.

At its core, the Roth 401(k) is similar to the Roth IRA, which has grown into a popular way to supplement employer-sponsored retirement plans since it was introduced in 1998. You save after-tax dollars during your working years in a mutual fund or other investments and then withdraw the money -- including all the profits the savings generated -- tax-free, so long as the account has been open five years or more and you are at least 59½ years old. (Unlike Roth IRAs, which aren't available to high-income folks, there are no income limits with Roth 401(k) plans.)

That tax-free growth is what differentiates the new Roth 401(k) from the old-fashioned 401(k). You will owe Uncle Sam nothing on years of compounded profits, which are likely to be the largest chunk of your account. With traditional 401(k) plans, you skip taxes today, but when you withdraw the money, you pay taxes at ordinary rates not just on the contributions but also on all of the compounded profits. That means a traditional 401(k) ultimately would provide a smaller

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amount of after-tax dollars to live on in retirement.

Roth 401(k) Basics

Come Jan. 1, workers will have the opportunity to save for retirement in a Roth 401(k) plan, which offers tax-free growth of your contributions. Here's a look at who a Roth 401(k) is and isn't right for. As always, you should check with a tax professional regarding your individual situation:

	CATEGORY	DESCRIPTION
ROTH 401(k)	Young workers	Money compounds tax-free for decades. Paying taxes on contributions at current rates is better than paying higher taxes later on contributions and profits.
	Older workers with substantial assets	Income from your assets in retirement could push you into a higher tax bracket. You'll benefit by paying taxes today.
	Workers with large balances in a traditional 401(k), 403(b) or traditional IRA	A Roth gives you tax-free access to some of your nest egg in retirement, allowing you to manage your tax situation by keeping you from being pushed into an even higher tax bracket.
	People looking to bequeath assets to heirs	You can roll Roth 401(k) assets into a Roth IRA with no tax consequences, meaning you ultimately can pass assets to heirs tax free.
	Older parents/grandparents saving for a child's college education	Tax-free access to money if the Roth is at least five years old and you're at least 59½ when the child enrolls. Plus, you retain the assets and retirement accounts generally aren't part of federal financial-aid calculations.
TRADITIONAL 401(k)	Older workers with little savings	You'll likely be in a lower tax bracket in retirement. You get a bigger benefit by reducing your taxes today.

The other key advantage with a Roth 401(k) is that it allows savers to roll the value of the account into a Roth IRA, effectively creating a way to transfer assets to heirs tax-free. That is because, while the Roth 401(k) imposes a requirement that certain sums begin to be distributed from the account at age 70½, the Roth IRA has no such rule.

Not many workers will have access to a Roth 401(k), at least initially. A survey over the summer by Hewitt Associates, the Lincolnshire, Ill., human-resources-consulting firm, found only 31% of 458 companies polled said they are "somewhat or very likely" to offer Roth 401(k) plans to their employees.

Big retirement-plan providers **Principal Financial Group** and Fidelity Investments each say interest in Roth 401(k) plans is modest among the corporate clients for which they manage retirement plans.

"Of the new plans we're signing up, less than 10%" are showing interest in the Roth 401(k), says Kevin Morris, marketing officer for Principal's Retirement Investment Services unit. **Charles Schwab Corp.** says it has signed up 51 companies that will begin offering Roth 401(k) plans on Jan. 1 and another 15 or so that will offer them later in the year, representing about 10% of the firm's total corporate clients.

All new retirement plans take time to catch on as savers digest the tax consequences and investment options. The Roth 401(k) is likely to be no different. Companies generally begin to offer particular benefits only after workers voice interest in them.

One company that will offer the Roth immediately is Plant & Flanged, a Blaine, Minn., supplier of water-treatment equipment. It met last week with its 17 employees to explain how the new retirement account will work. The company already offers a traditional 401(k) plan but opted to add a Roth, says co-owner Rod Ganther, "because if our company keeps growing, our people's

income and investments grow, and they'll benefit later" in retirement when they will be in a higher tax bracket.

That is a key issue workers must grapple with in deciding between Roth and traditional 401(k) plans: What tax bracket might they fall into in retirement?

"Seeing what your tax rate might be in the future is difficult for most people," says Matthew Chope, a partner at the Center for Financial Planning, a Southfield, Mich., firm.

For younger workers, it is a no-brainer. Younger workers typically fall into a lower tax bracket today, and if they save for retirement for decades, they almost certainly will be in a higher tax bracket when they begin withdrawing their savings later. Younger workers "should definitely choose the Roth over a traditional 401(k)," says Bryan Lee, president of Strategic Financial Planning, in Plano, Texas.

While equal contributions in a Roth or traditional 401(k) would ultimately grow to the same size, the traditional 401(k) imposes taxes on all the profits and contributions on the way out. The Roth only taxes the contributions on the way in.

Still, that tax hit on contributions now could turn off some younger workers for whom the Roth is an otherwise better proposition. A worker in, say, the 25% tax bracket would have to come up with \$20,000 before taxes to fully fund the \$15,000 contribution limit in a Roth 401(k) for 2006. Moreover, money saved via the tax break on a traditional 401(k) could be invested in another retirement vehicle, offsetting the Roth 401(k) advantage.

Saving in a Roth 401(k) generally isn't a great strategy for older workers with little savings. Those moving into their 50s generally don't have enough time remaining in the work force to benefit significantly from the tax break on the compounded growth of their profits.

In a pamphlet Principal Financial distributes to workers in plans it manages, the Des Moines, Iowa, retirement-services firm advises against the Roth 401(k) "if you are uncertain, or know you will be in a similar or lower tax bracket at retirement." The reason: You get a bigger tax break from a traditional 401(k) by saving pretax dollars today while you are in a higher tax bracket and then paying taxes at a lower rate later in retirement.

Older workers who know they will be in a higher tax bracket -- essentially those who already have or expect to have a large nest egg that will generate substantial income in retirement -- are likely to benefit from a Roth 401(k). They will get a bigger break by paying taxes at a lower rate today, rather than waiting to pay the higher tax rate they would face with traditional 401(k) distributions later.

Some older workers who may not be prime candidates for a Roth might want to start one, anyway, perhaps with just a token amount of their overall 401(k) contribution. That way, if their salary increases unexpectedly, they would have the Roth account in place in the event Congress ultimately decides not to allow the creation of anymore new ones. The law that created the Roth 401(k) is set to expire at the end of 2010, so Congress would have to extend it or make it permanent to allow new ones after that.

Older parents or grandparents saving for a child's college education can also benefit from a Roth. If you have at least five years to go before the child enrolls, and you will be at least 59½ at that

point, you will be able to pull money from the Roth tax-free to pay school bills. Whatever is left remains yours and, unlike a 529 college savings plan, doesn't have to be used for education expenses. Moreover, retirement accounts generally aren't counted as assets in federal financial-aid formulas, potentially helping a student obtain a larger slug of financial aid.

Write to Jeff D. Opdyke at jeff.opdyke@wsj.com¹

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(1) <mailto:jeff.opdyke@wsj.com>

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