**Re: Advantages and Disadvantages of a Roth 401(k)**

Dear Client:

I am writing in response to your recent inquiry involving the advantages and disadvantages of opening up a Roth 401(k).

The biggest advantage of a Roth 401(k) is that appreciation on the contributions are never taxed. However, this comes because of the main disadvantage of Roth 401(k)s - contributions are elective contributions under a qualified 401(k) plan that, unlike pre-tax 401(k) elective contributions, are currently includible in gross income. Therefore, contributions are from after-tax dollars.

Another advantage is that contributions can be made to a designated Roth 401(k) account even if income is too high to be eligible to contribute to a Roth IRA. Similar to a Roth IRA, an individual can begin distributions tax-free after age 59½ provided the individual has been in the plan for at least five tax years. One disadvantage of the Roth 401(k), as opposed to the Roth IRA, is that individuals are required to take distributions beginning when they turn age 70½. However, this rule can be circumvented by rolling over the Roth 401(k) account to a Roth IRA before turning 70½. The Roth IRA has no minimum distribution rules. Therefore, the funds in the account can continue to grow tax free.

As mentioned above, for a distribution to be a qualified distribution and therefore not includible in income, a five-year requirement must be met for both Roth IRAs and Roth 401(k)s. In contrast to how the five-year period is calculated for Roth IRAs, the five-tax-year rule for Roth 401(k)s is the period of five consecutive tax years that begins with the first day of the first tax year in which the employee makes a Roth 401(k) contribution to any designated Roth account established for the employee under the same plan and ends when five consecutive tax years have been completed. For a Roth IRA, the five-tax-year period begins with the first tax year for which a contribution is made to any Roth IRA.

In addition, unlike nonqualified distributions from a Roth IRA which are first treated as distributions of after-tax contributions and therefore are tax-free, distributions from a Roth 401(k) are prorated between after-tax contributions and taxable earnings. Therefore, if the account has appreciated, any distribution that is not a qualified distribution will have a taxable income component.

There is a disadvantage for an employer setting up the Roth 401(k) because the Roth 401(k) accounts must be maintained separately from the pre-tax 401(k) accounts and employer contributions may only be made to the pre-tax 401(k) accounts. This makes having a Roth 401(k) plan more expensive for the employer because of the additional paperwork required.

Please contact our office at your earliest convenience to make an appointment so we may discuss your individual situation.

Sincerely,