



Understanding the Roth 401(k) and Its Rules

Today, the Roth 401(k) has the same benefits to company-sponsored retirement plans that the Roth IRA brought to individual retirement accounts — tax shelter for investment earnings followed by tax exemption for qualified account withdrawals. The trade-off is forgoing any tax deduction for account contributions.

Plan participants may allocate their contributions to any combination of Roth and traditional accounts offered by their employer. Employers can match Roth 401(k) contributions as they might already do for traditional 401(k)s. However, the matching funds must be credited to a traditional account, even if the participant's contribution is made to a Roth account.

The familiar retirement account policies generally affect all types of 401(k)s. Nondiscrimination requirements, fiduciary responsibility, required minimum distribution rules, and early withdrawal penalties apply similarly to Roth and traditional employer-sponsored plans. There is a single contribution limit that is applied cumulatively to all employer-sponsored retirement accounts. It is \$19,500 for all participants in 2020, with an additional \$6,500 permitted to those aged 50 and above.

Comparison at a Glance

	Traditional 401(k)	Roth 401(k)
Tax Status of Contributions	Pretax contributions reduce current taxable income.	After-tax contributions do not alter current tax exposure.
Tax Status of Investment Earnings	Earnings are tax deferred when left in account.	Earnings are tax deferred when left in account.
Tax Status of Distributions After Age 59½	Earnings and contributions are taxed as current income when withdrawn.	Earnings and contributions can be withdrawn tax- and penalty-free for investors who have had the account for at least five years.
Rollovers to IRAs	May be rolled over directly to a traditional IRA without immediate tax consequences. May also be rolled over to a Roth IRA, but income taxes will apply for all pretax portions.	May be rolled over directly to a Roth IRA without immediate tax consequences.
Rollovers to Other Employer-Sponsored Plans	May be rolled over to traditional 401(k) and 403(b) plans only, but not to Roth plans.	May be rolled over into other Roth 401(k) or Roth 403(b) plans.