

What is the difference between a regular 401(k) deferral and a Roth 401(k) deferral?

Under either a regular 401(k) deferral or a Roth 401(k) deferral, you make a deferral contribution by electing to set aside part of your pay (by either a certain percentage or a certain dollar amount). For a regular 401(k) deferral, the taxable wages on your W-2 are reduced by the deferral contribution; therefore, you pay less current income tax. However, you will eventually pay tax on these contributions and earnings when the plan distributes the regular 401(k) deferrals and earnings to you. The result is that the tax on the regular 401(k) deferrals and earnings is only postponed.

A Roth 401(k) deferral is an after- tax contribution, which means that you must pay current income tax on the deferral. Since you have already paid tax on the deferral, you will not pay tax on it again when you receive a distribution of your Roth 401(k) deferral. In addition, if you satisfy certain distribution conditions, then you will not have to pay tax on the earnings either. This means that the distribution of the Roth 401(k) earnings can be tax-free, not just tax-postponed.

How do I get a tax-free distribution of Roth 401(k) earning?

If the distribution of your Roth 401(k) deferral account is made when you are at least 59 1/2, or upon your death or disability, then you may be entitled to a tax-free distribution of earnings. However, you must also satisfy the “5-year participation requirement.” The “5-year participation requirement” is satisfied once you have had funds in your Roth 401(k) account for 5 years. However, you do not have to make Roth 401(k) deferrals in each of the 5 years.

If a distribution from my Roth 401(k) does not meet the conditions for a tax-free treatment, what are my income tax consequences?

If a distribution from your Roth 401(k) deferral account does not satisfy the conditions to be tax-free, then you will pay income tax on your distributed Roth 401(k) earnings, but you will not be taxed again on the distributed Roth 401(k) deferrals. However, you may avoid the tax on the Roth 401(k) earnings by rolling over the Roth 401(k) deferral account to a Roth IRA, or other retirement plan that includes Roth deferral provisions.