

Q&A Employee Benefits



Courtesy of The Alpha Group

Q

What's the difference between a 401(k) and a Roth 401(k)?

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Traditional 401(k) plans and Roth 401(k) plans are both employer-sponsored retirement plans designed to assist employees in saving money for retirement.

A traditional 401(k) is an account in which employees can contribute pre-tax dollars through paycheck deductions that are directly deposited into said account. As a result, employee contributions to a 401(k) are not included in the employee's taxable income for the year. 401(k) contributions are also not taxed until the money is withdrawn, either at retirement or earlier. If withdrawals are made prior to retirement age (set by the IRS), they are generally taxed a higher amount than if the money stays in the account until retirement. When the money is distributed, it must be included in the employee's taxable income. Penalties for this type of early withdrawal are also likely to apply.

Employers will often match a certain percentage of employee contributions to a 401(k), up to a certain amount per dollar. Matching can motivate employees to contribute more money to the account, or at least enough to earn the full employer match.

A Roth 401(k) combines the features of a traditional 401(k) with those of a Roth IRA. Roth 401(k) contributions are made with *after-tax dollars* rather than pre-tax dollars. Withdrawals from the Roth 401(k) are tax-free as long as they are taken out after retirement age (set by the IRS). Generally, if an employer provides matching contributions for traditional 401(k) plans, it provides the same match for Roth 401(k) plans. However, the amount that the employer contributes is taxed as ordinary income when withdrawn. Also, a Roth 401(k) cannot stand alone as a retirement plan; it can simply be added to an existing 401(k) plan.

The main difference between a traditional 401(k) plan and a Roth 401(k) plan lies in the way the plan is taxed. Whether to offer a traditional 401(k) plan and/or a Roth 401(k) plan is a business decision. If an employer opts to offer both, clear communication to employees on the differences between plans is necessary.