Roth Accounts and Your Retirement

Quick, say the first thing that comes to mind when you hear the words “Roth account.” Chances are good that your first thought may be tax-free earnings. The potential for earning returns that aren’t subject to federal income taxes can be very appealing to investors.

The popularity of Roth accounts has prompted many employers to add a Roth option to their 401(k) retirement plan offerings. Unlike a traditional 401(k) plan, where contributions are made on a pretax basis and taxed, along with earnings, at withdrawal, contributions to a Roth 401(k) account are made *after* taxes. The advantage of a Roth 401(k) account is that distributions from the account are not subject to federal income taxes once certain conditions are met.

Different, but Alike

Despite their differences, a traditional 401(k) and a Roth 401(k) share one thing in common. Under both arrangements, you generally must begin taking annual required minimum distributions (RMDs) at age 70½. Failing to take a required withdrawal could result in a 50% penalty on the amount you should have withdrawn but didn’t. The RMD rule applies as well to any traditional individual retirement accounts (IRAs) you own. But — and here’s the good news — the RMD rule doesn’t apply to your Roth IRAs.

The Roth Strategy

You can avoid having to take minimum distributions from a Roth 401(k) by rolling over your account balance to a Roth IRA at retirement. Because a Roth IRA has no mandatory withdrawal requirements at any age during the life of the account owner, the money in your Roth IRA can continue to potentially grow tax free throughout your lifetime. If you never need the money, your Roth IRA can be passed to your loved ones, who would have to follow the applicable IRS rules on taking distributions.