MFS INVESTMENT MANAGEMENT®

# Roth 401(k) Plans

A new way to save for retirement

## Inside this issue



## Save with after-tax dollars

Roth 401(k) plans, which allow participants to put aside after-tax dollars for retirement, go into effect January 1, 2006. Because Roth 401(k) contributions have already been taxed—unlike traditional 401(k) contributions, which are made with pre-tax dollars—Roth 401(k) contributions and any investment earnings can be withdrawn tax-free. To avoid paying taxes on your Roth 401(k) withdrawals, your account must be held for at least five years and you must be at least age 59½ or distribution must be due to disability or death.

## Who should participate?

Because withdrawals are tax free, a Roth 401(k) may be a good option for participants who:

- **Are currently in a lower tax bracket and expect to be taxed at a higher rate in retirement.** For instance, this may be the case for younger workers who are just starting their careers and expect their income—and associated taxes—to increase over time

- **Prefer to pay taxes now, rather than later.** By paying taxes up front, you gain a clearer understanding of exactly how much money you'll have for retirement. Because you've already paid taxes on this money, your Roth 401(k) account balance at retirement represents exactly how much money you can withdraw and spend.

- **Seek to do with less money now in order to have a bigger nest egg later.** If you're in your highest earning years—typically workers who are age 35-55—you may want to sacrifice a few dollars now to have more after-tax dollars in retirement, when your income has either stopped or been reduced.

## Know your limits

As with a traditional 401(k) account, Roth 401(k) accounts are subject to IRS contribution limits. That means that the total of all your contributions between both accounts cannot exceed the following limits:

**IRS contribution limits**

| | 2005 | 2006 |
|---|---|---|
| Deferral limit | $14,000 | $15,000 |
| Additional catch-up contributions* | $ 4,000 | $ 5,000 |

*Catch-up contributions are only available to participants age 50 or older and only if your Plan allows such contributions.

# The 411 on the Roth 401(k)

The features of a Roth 401(k) are distinctly different than those of a traditional 401(k). Before deciding whether to participate in a Roth 401(k), please consider the following factors:

1. A Roth 401(k) account is separate from a traditional 401(k) account. As a result, Roth 401(k) contributions may not be transferred to or reclassified as a traditional 401(k) account.
2. Company matching funds (if applicable) will most likely be applied to both traditional 401(k) account contributions and to Roth 401(k) account contributions.
3. Your contributions are still subject to the IRS's maximum contribution limit (see prior page for contribution limits).
4. There are no adjusted gross income limits for designated Roth 401(k) contributions as there are for Roth IRA contributions.
5. To avoid early withdrawal penalties, money in a Roth 401(k) account must be held for at least five years, and you must be at least age 59½.*
6. Qualified distributions from a Roth 401(k) account are completely exempt from Federal taxation.
7. If you leave your job, you can roll your Roth 401(k) account over into another Roth 401(k) plan (if offered by your new employer) or a Roth IRA. Both options will allow you to make tax-free withdrawals upon retirement.*

*A qualified distribution is one made at least five years after the tax year the participant first makes a designated Roth 401(k) contribution to the plan. Withdrawals made prior to five years after the tax year of the contribution, made prior to age 59½, death or disability will be subject to taxation. Please consult a tax adviser for advice.

## It doesn't have to be one or the other

In short, you can choose to contribute to a Roth 401(k) which will likely have a noticeable impact on your take-home pay, you can stick with the traditional 401(k) and pay Uncle Sam later, or you can choose to hedge your bets by participating in both.

The bottom line? It's your choice, so take some time to understand your options so that you can choose what's best for you.



## Why is it called a Roth 401(k)?

The Roth 401(k) is so named because it combines features of the traditional 401(k) with those of a Roth IRA. It's offered by employers and contributions can be automatically deducted from your paycheck, just like a traditional 401(k). However, since you are contributing with after-tax dollars (and hence will later benefit from tax-free withdrawals), it also shares the features of a Roth IRA.

A key difference between a Roth 401(k) and a Roth IRA is the income restrictions. The Roth 401(k) has none, whereas a Roth IRA is generally available only to individuals who earn less than $95,000 alone or $150,000 jointly.

## Is the Roth 401(k) here to stay?

The Economic Growth & Tax Relief Reconciliation Act of 2001—the legislation authorizing the Roth 401(k)—expires at the end of 2010, and it's up to Congress to extend the Roth provisions. If the rules expire, investors should be able to roll accounts into Roth IRAs upon distribution.