

Roth 401(k) Deferrals

What is a Roth deferral?

A Roth 401(k) deferral is an after-tax contribution which means you must pay current income tax on the deferral. Since you have already paid tax on the deferral, you won't pay tax when you receive a distribution of your Roth deferral. In addition, if you satisfy certain distribution conditions, you won't pay tax on the earnings either. This means that the distribution of the Roth 401(k) earnings can be tax free, not just postponed as with regular pre-tax deferrals.

Who is eligible to make a Roth deferral?

If you are eligible to make regular 401(k) deferrals, you are eligible to make Roth deferrals.

Roth IRA's have income restrictions; are there income restrictions on Roth 401(k) deferrals?

No, you may make Roth deferrals regardless of your income.

Is there a limit on how much I may defer?

Roth 401(k) deferral limits are the same as the regular 401(k) deferral limits. You can split your annual elective deferrals between Roth and Pre-tax, but your combined contributions cannot exceed the deferral limit for the year.

May I convert my existing regular 401(k) account balance to a Roth 401(k) account?

Starting in January of 2017 you will be allowed to do what is called an 'in-plan conversion' to a Roth account.

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

If the distribution of your Roth 401(k) deferral account is made when you are at least age 59 ½, 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 participant 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.

Example: A participant terminated on his 55th birthday. He made his first Roth 401(k) deferral contribution in 2006. He may receive a distribution from the plan because he terminated employment, however, the Roth 401(k) earnings would not qualify for tax free treatment because he is not 59 ½. Now assume the same facts except he waits until the date he attains age 59 ½ to take his distribution. The entire distribution (including Roth 401(k) earnings) would qualify for tax free treatment because he has satisfied both conditions (5 year participant requirement and attainment of age 59 ½)

If a distribution from my Roth 401(k) deferral account does not meet the conditions for 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 won't be taxed again on the Roth 401(k) deferrals. You may avoid the tax on the Roth 401(k) earnings by rolling over the Roth 401(k) to another retirement plan that includes Roth provisions.

May I roll over my Roth 401(k) deferral account?

Yes. If you are entitled to a distribution from the plan, then you may roll over your Roth 401(k) deferral account, but only to a Roth IRA or to a 401(k) plan or 403(b) plan that permits Roth deferrals. You may not roll your Roth 401(k) deferral account to a regular IRA.

May I roll an outside Roth IRA into my Roth 401(k) account?

Generally, this is prohibited. However, if the Roth IRA consists solely of money that was rolled from a Roth 401(k) or Roth 403(b) account and any earnings on those Roth accounts, you would be able to do a rollover to the 401(k). However, if you had made any contributions to the Roth IRA, you cannot roll any of that money from the account into the 401(k).

What factors should I consider in deciding whether to make a Roth 401(k) deferral or a regular 401(k) deferral?

In general, the longer Roth 401(k) deferrals remain in the plan, the more favorable they are (i.e., the Roth deferrals may result in more tax savings than regular 401(k) deferrals). However this is not always the case. Another item to think about is your federal income tax rate at the time of the contribution, compared to your expected tax rate at the time you would receive a distribution. Regular 401(k) deferrals are taxed when distributed. Roth 401(k) deferrals are taxed when these are made to the plan. If you believe that your tax rate will be lower in the future when you receive distributions from the plan, then you should consider making regular 401(k) deferrals to the plan. If you believe that your tax rate will be higher when you receive distributions from the plan, then you should consider making Roth 401(k) deferrals. Your tax rate when you receive a distribution will depend on your taxable income at that time as well as changes in the tax laws.

When you are deciding on the type of contribution to make, you should also think about when you will want, or need, to withdraw the contributions from your account. If you think you will withdraw your contributions before you satisfy the 5 year participation requirement, then you may be better off making regular 401(k) deferrals.

The factors to consider when deciding whether to make Roth 401(k) deferrals or regular 401(k) deferrals depend upon many unknown items. Because of this, it is sometimes suggested that you consider making both regular 401(k) deferrals and Roth 401(k) deferrals. This may give you flexibility to control both the timing of distributions as well as your income tax consequences (e.g., if funds are needed prior to satisfaction of the 5 year participation requirement, then withdraw from your regular 401(k) deferral account, or if the 5 year participation requirement has been met and your tax bracket is high in a particular year, then withdraw from your Roth 401(k) deferral account). Ultimately, it is a personal decision that requires careful consideration.