

ROTH 401(k) DEFERRALS

Before you decide whether to make Roth 401(k) deferrals, you should review this information to determine if this option is best for you.

What is the difference between a regular 401(k) deferral (pre-tax) 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 you must pay current income tax on the deferral. Since you have already paid tax on the deferral, you won't 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 won't 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.

Who is eligible to make a Roth 401(k) deferral?

If you are eligible to make a regular 401(k) deferral under your 401(k) plan, and the plan allows for Roth deferrals, then you will be eligible under the Roth 401(k) deferral option.

Roth IRAs have income restrictions; are there income restrictions for making Roth 401(k) deferrals?

No. In order to be able to make Roth IRA contributions, your income must be below a certain dollar amount. However, you may make Roth 401(k) deferrals regardless of your income.

How do I make a Roth 401(k) deferral contribution?

You make a Roth 401(k) deferral contribution the same way that you make a regular 401(k) deferral contribution by payroll deduction. You elect to contribute a certain percentage or dollar amount of your pay. When you elect how much you want to contribute, you must also specify whether the contribution is either a Roth 401(k) deferral or a regular 401(k) deferral.

May I contribute a Roth 401(k) deferral out of my own savings?

No. You may not make any 401(k) deferrals by contributing money out of your own savings directly to the plan.

Is there a limit on how much I may defer?

For 2018, the Roth 401(k) deferral limit is \$18,500 (\$24,500 if you are allowed to make catch up contributions), the same limit as the regular 401(k) deferral limit.

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

If the plan document provides for an in-plan Roth conversion.

Under our plan, are Roth 401(k) deferrals treated differently than regular 401(k) deferrals?

Other than the different tax treatment, Roth 401(k) deferrals are generally treated the same as regular 401(k) deferrals.

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 he terminated employment at age 60 and made his first Roth 401(k) deferral in 2006 he could receive a distribution due to termination of employment but the earnings would not qualify for tax free treatment because the 5 year participation requirement had not been satisfied. However, if he waited until the 5 year participation requirement was satisfied the earnings would be distributed tax free.

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.

If a distribution from my Roth 401(k) deferral account does not qualify for tax free treatment, is the distribution subject to any penalty taxes?

The Roth 401(k) earnings portion of your account would be subject to a 10% penalty tax unless one of the penalty exceptions applies. The distribution of the Roth 401(k) deferral portion is not subject to the 10% penalty tax. In general, the 10% penalty tax does not apply to the taxable portion of a distribution if the distribution is made (1) after attainment of age 59 ½; (2) after termination of employment when attaining age 55, (3) upon death or disability, (4) after termination of employment and payable in substantially equal installments over your lifetime, or (5) to pay for deductible medical expenses.

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 or to any other plan.

If my beneficiary receives a distribution from my Roth 401(k) deferral account, will the death benefit qualify for tax free treatment?

A distribution to the beneficiary of your Roth 401(k) account may qualify for tax free treatment. Death is one of the three qualifying distribution events. However, death is not an exception to the 5 year participation requirement. In other words, if you have not satisfied the 5 year participation requirement before your death, then the beneficiary would need to wait until the end of the 5 year participation period before a distribution of your Roth 401(k) earnings would qualify for tax free treatment.

If I make Roth 401(k) deferrals, may I also contribute to my regular IRA or Roth IRA?

Yes. Your Roth 401(k) deferrals do not affect your ability to make Roth IRA contributions. Similarly, your Roth IRA contributions do not affect your ability to make Roth 401(k) deferrals. However, there is an income limitation that restricts who can contribute to a Roth IRA.

Your Roth 401(k) deferrals also do not affect your ability to make regular IRA contributions. However, because you are an active participant in our plan, if you want the regular IRA contribution to be deductible, then your income must be below certain income limitations.

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

Your decision to make Roth 401(k) deferrals or regular 401(k) deferrals involves a number of factors that are discussed below. 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 so you must think about several things before making your decision.

Ability to afford higher contributions – One of the most important items to think about is whether your decision to contribute regular 401(k) deferrals or Roth 401(k) deferrals will affect the amount of salary deferrals that you can afford to contribute to the plan. If you can afford to contribute the same dollar amount of salary deferrals, regardless of whether they are regular 401(k) deferrals or Roth 401(k) deferrals, then that means you should think more about making Roth 401(k) deferrals. This is because Roth 401(k) deferrals are generally worth more than regular 401(k) deferrals, since tax has already been paid on the Roth 401(k) deferrals.

Your ability to afford higher contributions becomes more important in two situations: (1) when a plan provides for a matching contribution, or (2) when you want to contribute the maximum amount allowed by our plan or by the law. In the case of matching contributions, it is to your benefit to contribute the maximum amount that will be matched under the plan. If you are not able to contribute enough Roth 401(k) deferrals to receive the maximum matching contribution, then you may be better off making a larger contribution with regular 401(k) deferrals.

Current and future tax rates – 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 the deferrals will be withdrawn – 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.

Another factor relating to the timing of distributions is whether you want to accumulate funds in a retirement plan for as long as possible. Regardless of whether you make regular 401(k) deferrals or Roth 401(k) deferrals, you must begin receiving distributions from our plan as of the later of your retirement or your attainment of age 70 1/2. However, for estate planning purposes, you may want to delay the receipt of your distribution beyond your retirement or your attainment of age 70 1/2. You can delay the distribution of Roth 401(k) deferrals if you roll over the Roth 401(k) deferrals and earnings to a Roth IRA.

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.