PRE-MEETING OVERVIEW

MAKING AFTER-TAX 401(K) CONTRIBUTIONS

COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

What to know before your meeting

Between 25% and 30% of 401(k) plans today allow participants to make after-tax contributions other than designated Roth contributions.[1] These accounts can be a vehicle for setting aside more assets that have the ability to grow on a tax-deferred basis and accumulating assets that may be more tax-advantaged when distributed in retirement.

As you discuss after-tax contributions with your financial advisor, you may find that setting aside a portion of your salary above your pretax salary deferrals and designated Roth contributions is appealing. By making after-tax contributions to your 401(k) plan now, you could build a source of assets for a potentially tax-efficient Roth conversion — and gain more flexibility in managing your tax liability in retirement.

Questions to review before your meeting

Q: Does your plan allow for after-tax contributions?

A: While not allowed by all plans, if an after-tax contribution option is available, details of the option should be included in the summary plan description (SPD). If you don't have a copy of the SPD, ask your human resources department or log on to your benefits website for a copy. You can also talk to your financial advisor about other ways to obtain plan information.

Q: What does after-tax mean?

A: After-tax means you instruct your employer to take a portion of your pay — without lowering your taxable wages for federal income tax purposes — and deposit the amount into a separate after-tax account within your 401(k) plan, where it grows tax-deferred. This process differs from your pretax option in which your employer takes a portion of your pay and reduces your reported federal taxable wages by the amount of your salary deferrals[2] and deposits the funds to your pretax deferral account within the plan. While you are not getting a tax benefit up front from your after-tax account, when you withdraw it, only the gains will be taxable income to you.

Q: Are there restrictions?

A: Even if your plan has an after-tax contribution option, there are limits to the amount you can set aside on an after-tax basis. Your after-tax contributions combined with your employee salary deferrals and employer contributions for 2020, in total, cannot exceed $57,000 (or $63,500 if you are age 50 or older and making catch-up contributions). Your after-tax contributions could be further limited by the plan document and/or to meet certain nondiscrimination testing requirements.

[1] Plan Sponsor Council of America, 61st Annual Survey, 2018 and Retirement Learning Center plan document database, 2020.

[2] Employee contributions, whether pretax or after-tax, are subject to Social Security (FICA), Medicare and federal unemployment taxes (FUTA).

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Q: How does a 401(k) after-tax account help me acquire Roth assets?

A: When you are eligible to withdraw your 401(k) after-tax account, you have four options: 1) Leave the account in the plan; 2) Distribute an amount; 3) Roll an amount over to an eligible plan; or 4) Convert an amount to a Roth IRA or a designated Roth account in your plan, if available. Before making a decision, be sure to discuss with your tax advisor the pros and cons of each scenario, including the potential tax and penalty implications, investment options, fees and expenses, services, protection from creditors, required minimum distributions and impact to employer stock.

For example, an in-plan conversion to a designated Roth account could require you to include any converted pretax earnings in your taxable income for the year. In contrast, a conversion to a Roth IRA of your after-tax account could be tax-free. A special rule found in IRS Notice 2014-54 allows you to direct the distributing plan administrator to send the pretax portion of the distribution (the earnings) to a traditional IRA and the after-tax portion to a Roth IRA, resulting in a tax-free rollover and conversion.

And if you have pre-1987 after-tax contributions, special rules allow you to convert just those contributions without including any of the associated earnings.

Checklist to complete before your meeting

Before you meet with your financial advisor, you may want to gather:

- [ ] The most recent statement from your 401(k) plan
- [ ] Any plan documentation you may have, such as an SPD
- [ ] The telephone numbers of your current and former employers' benefits administrators so you and your financial advisor can confirm information
- [ ] Any retirement income planning documents you may have accumulated
- [ ] The contact information for your tax advisor should you have any tax-related questions

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