Memorandum

To: 401(k) Plan Participants
From:
Date:
Re: **Addition of Roth 401(k) to our Plan**

Roth 401(k) Overview

As of ______________________, we are adding a new Plan feature which will permit you to make 401(k) contributions on either:

- the traditional pre-tax basis,
- an after-tax basis known as Roth 401(k), or
- as a combination of both contribution types.

This additional feature does <u>not</u> double the 401(k) limits. There is still only one contribution limit for both the traditional pre-tax 401(k) and the after-tax Roth 401(k). The 2024 limits are:

- $23,000 under the basic 401(k) limit, plus
- $7,500 under the catch-up limit for employees who are age 50 or older.

The advantage of Roth 401(k) contributions is the ability to **grow your investments on a tax-free basis** instead of the tax-deferred basis that is available under traditional 401(k) rules. **The disadvantage is that you will pay your taxes <u>now</u>**, as you put your Roth 401(k) money into the Plan.

No Income Restrictions: Roth 401(k) contributions do not have the same income restrictions associated with Roth IRA contributions. **A high income earner in 2024 ($161,000 for single tax filers and $240,000 for married filers) can take advantage of Roth 401(k).** Individuals who are eligible for Roth IRAs can also contribute under the Roth 401(k) rules. Of course, the Roth IRA limits are still significantly lower than the 401(k) limits, so the ability to save additional dollars under this new feature should be attractive to savers regardless of their income level.

Basic Roth 401(k) Rules

- Distributions from Roth 401(k) accounts – including contributions and investment earnings – are tax-free if they are **Qualified Distributions**. To be Qualified, the following criteria must be met:
  - The funds must be held for 5 years, measured from the 1st year that contributions were made to the Roth 401(k) account; **and**
  - The distribution must be made after age 59 ½, or on account of death or disability. Distributions for first-time home purchases do <u>not</u> qualify as they do for Roth IRAs.
- If you take a premature distribution that is not a Qualified Distribution (i.e. before age 59 ½ and 5 years), the amount is prorated between contributions, which are not taxed, and earnings, which are. For example, if your $20,000 account balance comprises $15,000 in contributions and $5,000 in earnings, 75% of any distribution would be tax-free, and 25% would be taxed.
- Rollovers may be permitted from one Roth 401(k) account to another. The five-year measuring period will start with the date the earlier Roth account was established. However, if rolled over to a Roth IRA, the 5-year period begins again from the date of the Roth IRA establishment.

- **A way to avoid Required Minimum Distributions**: Roth 401(k) accounts are subject to RMDs at age 73 but, can be avoided with a rollover from the Roth 401(k) to a Roth IRA, which is not subject to RMDs.
- Traditional 401(k) accounts **can now** be converted to Roth 401(k) accounts within the Plan itself without the requirement that the amount be otherwise distributable. Such conversions will be subject to income tax in the year of the conversion.
- Important Note: Roth 401(k) accounts are generally **not** available for participant loans, but are used in the calculation to determine maximum loan availability. In addition, Roth 401(k) accounts are generally **not** available for Hardship Withdrawals. Roth 401(k) accounts are only available as in-service distributions after age 59 ½ if they are deemed to be Qualified Distributions.

Conclusion

The ability to offer the convenience of payroll deduction for both pre-tax and after-tax savings provides a greater opportunity for retirement saving no matter which option you choose. Deciding which way to contribute will depend on a number of factors, including your current and expected future tax brackets, length of time before retirement (or expected use of funds), the amount of your current accumulation in pre-tax retirement accounts, etc.

Whatever your decision may be, having the flexibility of both options in your Plan and the ability to change from year to year may be very valuable over time. Those individuals with large accumulations in their pre-tax accounts, and especially those in high income tax brackets who are not eligible for Roth IRAs, may want to strongly consider the Roth 401(k) option. No matter what tax bracket you may be in during retirement or where you believe tax rates may go, having the option to withdraw both taxable and tax-free money in retirement is a valuable planning tool.

One basic and simple guideline for deciding how to contribute is if you can financially afford to continue making the same level of contribution on an after-tax basis that you were making pre-tax, then you should consider changing your election to Roth 401(k).

Remember, any employer contributions made to the Plan will continue to be deposited on a pre-tax basis, so electing Roth is a good way to have both sources accumulate simultaneously.