The Roth 401(k)

Some employers offer 401(k) plan participants the opportunity to make Roth 401(k) contributions. If you have access to this option, Roth contributions could play an important role in helping enhance your retirement income.

What is a Roth 401(k)?

A Roth 401(k) is simply a traditional 401(k) plan that accepts Roth 401(k) contributions. Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA contributions. This means there's no up-front tax benefit, but if certain conditions are met, your Roth 401(k) contributions and all accumulated investment earnings on those contributions are free of federal income tax when distributed from the plan. [403(b) and 457(b) plans can also allow Roth contributions.]

Who can contribute?

Once you're eligible to participate in a 401(k) plan, you can make Roth contributions regardless of your salary level. (This is in contrast to a Roth IRA where your ability to contribute may be limited or eliminated if your income exceeds certain amounts.)

How much can I contribute?

There's an overall cap on your combined traditional pre-tax and after-tax Roth 401(k) contributions. You can contribute up to $22,500 of your pay ($30,000 if you're age 50 or older) to a 401(k) plan in 2023 (up from $20,500 and $27,000 in 2022). You can split your contribution any way you wish. For example, you can make $11,000 in Roth contributions and $11,500 in traditional pre-tax 401(k) contributions. It's up to you.

If you also contribute to another employer's 401(k), 403(b), SIMPLE, or SAR-SEP plan, your total contributions to all of these plans — both traditional pre-tax and Roth — can't exceed $22,500 ($30,000 if you're age 50 or older) in 2023. It's up to you to make sure you don't exceed these limits if you contribute to plans of more than one employer.

Can I also contribute to a Roth IRA?

Yes. Your participation in a Roth 401(k) plan has no impact on your ability to contribute to a Roth IRA. You can contribute to both if you wish (assuming you meet the Roth IRA income limits). You can contribute up to $6,500 to a Roth IRA in 2023, $7,500 if you're age 50 or older (or, if less, 100% of your taxable compensation), increased from $6,000 and $7,000, respectively, in 2022.[1]

1 If you have both a traditional IRA and a Roth IRA, your combined contributions to both cannot exceed $6,500 ($7,500 if age 50 or older) in 2023.

ROCKLAND TRUST
Investment Management Group

Should I make traditional pre-tax or Roth 401(k) contributions?

When you make pre-tax 401(k) contributions, you don't pay current income taxes on those dollars, but your contributions and investment earnings are fully taxable when you receive a distribution from the plan. In contrast, Roth 401(k) contributions are subject to income taxes up front, but qualified distributions of your contributions and earnings are entirely free of federal income tax.

The decision depends on your personal situation. If you think you'll be in a similar or higher tax bracket when you retire, Roth 401(k) contributions may be more appealing. However, if you think you'll be in a lower tax bracket when you retire, pre-tax 401(k) contributions may be more appropriate. Your investment horizon and projected investment results are also important factors. Before you take any specific action, be sure to consult with your own tax professional or legal counsel.

Are distributions really tax-free?

Because your Roth 401(k) contributions are made on an after-tax basis, they're always free of federal income tax when distributed from the plan. But the investment earnings on your Roth contributions are tax free only if you meet the requirements for a "qualified distribution." In general, a distribution is qualified only if it satisfies both of the following:

• It's made after the end of a five-year waiting period
• The payment is made after you turn 59½, become disabled, or die

The five-year waiting period for qualified distributions starts with the year you make your first Roth contribution to your employer's 401(k) plan. For example, if you make your first Roth contribution to the plan in December 2023, then the first year of your five-year waiting period is 2023, and your waiting period ends on December 31, 2027.

But if you change employers and roll over your Roth 401(k) account from your prior employer's plan to your new employer's plan (assuming the new plan accepts Roth rollovers), the five-year waiting period starts instead with the year you made your first contribution to the earlier plan.

If your distribution isn't qualified (for example, you receive a payout before the five-year waiting period has elapsed), the portion of your distribution that represents investment earnings on your Roth contributions will be taxable, and will be subject to a 10% early-distribution penalty unless you are 59½ or another exception applies.

You can generally avoid taxation by rolling your distribution over to a Roth IRA or to another employer's Roth 401(k), 403(b), or 457(b) plan, if that plan accepts Roth rollovers. You may also leave the assets in the current plan, if the plan permits. State income tax treatment of Roth 401(k) contributions may differ from the federal rules.[2]

2 You can avoid tax on the non-Roth portion of your distribution (any pre-tax contributions, employer contributions, and investment earnings on these contributions) by rolling that portion over to a traditional IRA. When considering whether to make a rollover or to keep your funds in your 401(k) plan, you should consider carefully the investment options, fees and expenses, services, ability to make penalty-free withdrawals, degree of creditor protection, and distribution requirements associated with each option. Roth IRAs are subject to separate five-year holding periods.

What about employer contributions?

While employers don't have to contribute to 401(k) plans, many will match all or part of your contributions. Your employer can match your Roth contributions, your pre-tax contributions, or both. Prior to 2023, employer contributions were required to be made on a pre-tax basis, even if they match your Roth contributions. Beginning in 2023, you may be able to elect to have matching contributions invested in your Roth account (on an after-tax basis), provided you are fully vested in those contributions.

What else do I need to know?

Like pre-tax 401(k) contributions, your Roth 401(k) contributions and investment earnings can be distributed from the plan only after you terminate employment, incur a financial hardship, attain age 59½, become disabled, or die.

Also, you must begin taking distributions from a Roth 401(k) plan (but not a Roth IRA) after you reach age 73 (for those who reach age 72 after December 31, 2022), or in some cases, after you retire. But this isn't as significant as it might seem, since you can generally roll over your Roth 401(k) dollars (other than RMDs themselves) into a Roth IRA if you don't need or want the lifetime distributions. [Beginning with the 2024 tax year, distributions will no longer be required from Roth 401(k)s]

Note that employers aren't required to make Roth contributions available in their 401(k) plans.

	Roth 401(k)	Roth IRA
Maximum contribution (2023)	Lesser of $22,500 or 100% of compensation	Lesser of $6,500 or 100% of compensation
Age 50 catch-up (2023)	$7,500	$1,000
Who can contribute?	Any eligible employee	Only if under income limit
Age 73 required distributions?	Yes (through 2023)	No
Potential matching contributions?	Yes	No
Potential loans?	Yes	No
Tax-free qualified distributions?	Yes, 5-year waiting period plus either age 59½, disability, or death	Same, plus first-time homebuyer expenses (up to $10,000 lifetime)
Nonqualified distributions	Pro-rata distribution of tax-free contributions and taxable earnings	Tax-free contributions distributed first, then taxable earnings
Investment choices	Limited to plan options	Virtually unlimited
Federal bankruptcy protection	Unlimited	$1,512,350 (all IRAs aggregated)[3]

3 As of April 1, 2022 (the limit is adjusted for inflation every three years). SEP/SIMPLE IRAs and amounts rolled over from qualified employer retirement plans and 403(b) plans are not included in or subject to this limit, and are fully protected if you declare bankruptcy. Inherited IRAs are not entitled to federal bankruptcy protection but may be protected under the laws of some states.

ROCKLAND TRUST

Investment Management Group