WELLS FARGO Advisors

Roth 401(k)

Answers to frequently asked questions

Have you always wanted to contribute to a Roth IRA but have been unable to because of the modified adjusted gross income (MAGI) limits? If so, consider taking advantage of the Roth 401(k) feature.*

Overview

A Roth 401(k) is a plan feature that allows participants to contribute a portion of their wages into a 401(k) plan on an after-tax basis. If a Roth 401(k) is offered, participants must also have the option to make traditional, pretax salary deferral 401(k) contributions. Qualified distributions from a Roth 401(k) are tax-free.

Is a Roth 401(k) right for you?

If you like the idea of having a diversified retirement income of tax-free and taxable alternatives at retirement, you may consider a Roth 401(k).

How are Roth 401(k) contributions treated under an employer's plan?

Roth 401(k) contributions are treated as salary deferral and must be designated as Roth contributions before the date they are contributed to the plan. A participant's total salary deferral contributions (pretax and Roth) in 2020 cannot exceed $19,500. Participants aged 50 or older (before December 31) can also make $6,500 in additional catch-up contributions.

If I make Roth 401(k) contributions and later change my mind and want them treated as pretax contributions, can they be recharacterized and transferred to the traditional pretax account?

No, once contributions are designated as Roth 401(k) contributions, they cannot be recharacterized.

Do Roth 401(k) contributions need to be tracked separately from pretax 401(k) contributions?

Yes, 401(k) plans must account separately for designated Roth contributions. Roth 401(k) contributions and distributions must be credited and debited to an employee's Roth account, and the plan must maintain a record of the basis (contributions) and earnings within a Roth account. Earnings, losses, and other credits or charges applicable to Roth contributions must be separately allocated to an employee's Roth 401(k) account.

* The Roth 401(k) can be offered only as an added feature to a 401(k) plan.

Investment and Insurance Products: ▶ NOT FDIC Insured ▶ NO Bank Guarantee ▶ MAY Lose Value

What are the tax implications of a Roth 401(k) distribution?

A participant must incur a triggering event, as defined by the plan, in order to take a distribution from a retirement plan, including a Roth 401(k). A distribution of Roth assets is considered qualified [based on IRC 402A(d)(2)] only after the assets are held in the account for at least five years and the participant reaches age 59½ or older, dies, or becomes disabled. The five-year holding period begins on January 2 of the earlier of either (1) the first taxable year for which the participant makes a Roth 401(k) contribution under the distributing retirement plan or (2) the first taxable year the participant made a Roth 401(k) contribution to a previously held Roth 401(k) account that was rolled into the current Roth 401(k).

What happens if I take a nonqualified distribution from my designated Roth account?

A nonqualified distribution will be made pro rata from Roth contributions and earnings and is included in the distributee's gross income. Contributions are not subject to taxation; however, earnings will be subject to ordinary income taxes and premature distribution penalties, if applicable.

For example, a $5,000 nonqualified distribution is made from an employee's designated Roth account where the account balance is $10,000 and consists of $9,400 of designated Roth contributions and $600 in earnings. Based on a pro rata allocation, the distribution would consist of $4,700 of designated Roth contributions (which are not eligible to be included in the employee's gross income) and $300 in earnings (which are eligible for inclusion in the employee's gross income).

Can an investor contribute to both a Roth IRA and a Roth 401(k) plan?

Yes, making Roth 401(k) contributions does not affect an investor's eligibility to contribute to a Roth IRA and vice versa.

Do plans have to amend their 401(k) documents to include the Roth 401(k) feature?

Yes, plans must be amended.

Can you roll over a Roth 401(k) distribution? If so, how?

A participant can do a direct plan-to-plan rollover of a Roth 401(k) distribution from one 401(k) plan to another 401(k) plan as long as the receiving plan allows it. Alternatively, a participant can make a plan-to-plan or 60-day rollover of a distribution from a Roth 401(k) into a Roth IRA. Rollovers from a Roth IRA into a Roth 401(k) are not permitted.

How is the five-year clock handled for rollovers?

If the participant rolls a Roth 401(k) distribution from Plan A to Plan B, for example, the five-year clock in Plan B starts ticking on January 1 of the earlier of either the year the participant first made a Roth deferral to Plan B or the year the participant first made a Roth deferral to Plan A. If the participant rolls his or her Roth 401(k) balance into a Roth IRA, the time during which the assets were in the Roth 401(k) no longer applies and all money in the Roth is subject to the Roth IRA's five-year holding period.

Are Roth 401(k)s subject to Required Minimum Distribution (RMD) rules?

Yes, participant's Roth 401(k) account balances are subject to the RMD rules.

Can a participant do an in-plan conversion of pre-tax contributions to a Roth 401(k)?

If the plan document allows. However, this is a specific provision in the document. If the plan allows for Roth contributions, it doesn't necessarily mean that in-plan conversions are allowed. Note: In-plan conversions are recognized as ordinary income in the year converted.

You can count on us

Whether you're an employer interested in adding the Roth 401(k) feature to your 401(k) plan or a plan participant thinking about contributing to your employer's Roth 401(k), you can turn to your Financial Advisor for the help you need.

Please keep in mind that rolling over your qualified employer-sponsored retirement plan (QRP) to an IRA is just one of multiple options for your retirement plan. Each of the following options are different and may have distinct advantages and disadvantages.

- Leave assets in your former QRP, if plan allows
- Move assets to your new/existing QRP, if plan allows
- Cash out or take a lump-sum distribution

Each of these options has advantages and disadvantages and the one that is best depends on your individual circumstances. You should consider features such as investment options, fees and expenses, and services offered. Your Wells Fargo Advisors Financial Advisor can help educate you regarding your options so you can decide which one makes the most sense for your specific situation. Before you make a decision, read the information provided in this piece to become more informed and speak with your current retirement plan administrator and tax professional before taking any action.

When considering rolling over your QRP assets, key factors that should be considered and compared between QRPs and the IRAs include fees and expenses, services offered, investment options, when penalty-free withdrawals are available, treatment of employer stock, when required minimum distributions begin, and protection of assets from creditors and bankruptcy. Investing and maintaining assets in an IRA will generally involve higher costs than those associated with QRPs. You should consult with the plan administrator and a professional tax advisor before making any decisions regarding your retirement assets.

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