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PENSION SERVICES

AFTER-TAX EMPLOYEE CONTRIBUTIONS

For owner-only 401(k) plans

After-tax contributions (or employee voluntary contributions) are an additional type of contribution that can be made to a qualified plan. These contributions are made by the employee, but are not deferrals. They are made on an after-tax basis, like Roth deferrals, but earnings do not grow tax-free, they grow ***tax-deferred***. However, employees can roll these contributions into their own Roth IRA, or convert to Roth through an in-plan Roth rollover. Then, these funds ***can*** begin to grow tax-free.

MAIN BENEFITS:

Roth benefits for higher-income individuals. Higher-income taxpayers cannot make individual Roth IRA contributions due to the income limits that apply for these accounts. The income limits do not apply to Roth 401(k) contributions, and do not apply to conversions of contributions to Roth IRAs.

More savings potential. After-tax contributions are not deferrals, and therefore are not subject to the 402(g) limit ($24,500 for 2026). They are also not included in the deduction limit, like employer contributions are. However, they are included in the annual additions limit ($72,000 for 2026). As a result, there is potential for someone to put a larger amount into the plan than they could otherwise with just deferrals and employer contributions.

Additional contribution limit use. Qualified plans are typically limited to a 25% of compensation deduction limit for employer contributions, such as profit sharing. In addition, if a business has both a defined benefit and a 401(k) plan, the combined deduction limits may further reduce what can be contributed as a profit sharing contribution. This results in an unused contribution limit in the 401(k) plan, which could potentially be used up with after-tax employee contributions. Here is an example for one participant using the 2026 IRS limits:

Deductible 401(k) and Catch-up Contributions	$24,500
Maximum Deductible Profit Sharing Contribution	$19,800
Total Deductible Contribution	$44,300
Total Maximum Contribution Available	$72,000
Remaining Contribution Available	$27,700

The remaining $27,700 may be contributed by the participant to the plan on an after-tax basis. Further, it can be immediately converted to a Roth account. This contribution is not tax-deductible, but if it is converted to Roth, earnings will grow tax-free, and the eventual withdrawal of this account will be tax free if certain conditions are met.

IMPORTANT CAVEATS

Compliance testing issue. It is important to note that this type of strategy is typically only effective for owner-only plans. This is due to the inclusion of after-tax contributions in ACP (actual contribution percentage) testing. The ACP test must be passed yearly to ensure highly compensated employees (HCEs) are not benefitting disproportionately more than non-highly compensated employees (NHCEs). Therefore, if only HCEs are taking advantage of this contribution option, and NHCEs are either not getting a match, or only a small match, the plan will fail ACP testing. Then, the after-tax contribution must be refunded to the HCE. The ACP testing will apply even if the plan doesn't provide a matching contribution, and even if the plan is safe harbor! This caveat makes this option impossible for many plans, but does not impact owner-only plans.

Inclusion in plan document. A qualified plan must have the after-tax employee contribution provisions included in the document to make these contributions available. If the business owner wants to make an after-tax contribution count towards their 2026 annual additions limit, it must be deposited in 2026, or within 30 days of the end of the plan year. The owner cannot wait until their tax return due to date to make this deposit. Therefore, some pre-planning will need to take place to take advantage of this option.